STANDARD & POOR'S RATINGS SERVICES

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Presale:

Paragon Mortgages (No.17) PLC

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Presale:

Paragon Mortgages (No.17) PLC

£200 Million Mortgage-Backed Floating-Rate Notes

This presale report is based on information as of Oct. 16, 2012. The ratings shown are preliminary. This report does not constitute a recommendation to buy, hold, or sell securities. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings.

Class	Prelim. rating*	Prelim. amount (mil. £)	Available credit support§ (%)	Interest	Step-up margin	Optional call date	Legal final maturity
A	AAA (sf)	175.0	12.56	Three-month LIBOR plus a margin	Three-month LIBOR plus a margin	January 2016	April 2040
B	AA (sf)	10.5	7.31	Three-month LIBOR plus a margin	Three-month LIBOR plus a margin	January 2016	April 2040
C	A (sf)	10.0	2.31	Three-month LIBOR plus a margin	Three-month LIBOR plus a margin	January 2016	April 2040
D	NR	4.5	0.06	Three-month LIBOR	Three-month LIBOR	January 2016	April 2040

*The rating on each class of securities is preliminary as of Oct. 16, 2012, and subject to change at any time. We expect to assign initial credit ratings on the closing date subject to a satisfactory review of the transaction documents and legal opinion. Standard & Poor's ratings address timely receipt of interest and ultimate repayment of principal. §This is the initial credit support LIBOR--London interbank offered rate. NR--Not rated.

Transaction Participants	
Seller	Paragon Mortgages (2010) Ltd.
Warehouser	Paragon Fourth Funding Ltd.
Administrator	Moorgate Asset Administration Ltd.
Substitute administrator	Homeloan Management Ltd.
Subordinated lender	Paragon Finance PLC
Corporate services provider	Moorgate Asset Administration Ltd.
Issue services provider	Paragon Finance PLC
Hedge provider	Macquarie Bank Ltd., London Branch
Account bank	National Westminster Bank PLC
Trustee	Citicorp Trustee Company Ltd.
Principal paying agent	Citibank, N.A., London Branch
Registrar	Citibank, N.A., London Branch
Arranger	Macquarie Bank Ltd., London Branch
Joint lead manager	Lloyds TSB Bank PLC
Joint lead manager	Macquarie Bank Ltd., London Branch
Joint lead manager	Morgan Stanley & Co. International PLC

Supporting Ratings	
Institution/role	**Ratings**
National Westminster Bank as transaction account bank provider and seller collection account provider.	A/Stable/A-1
Macquarie Bank Ltd., London Branch as swap counterparty.	A/Stable/A-1

Transaction Key Features*	
Expected closing date	October 2012
Collateral	U.K. buy-to-let mortgage loans
Principal outstanding of the provisional pool (mil. £)	140.25
Country of origination	England and Wales
Concentration (%)	South East and London: 49.06
Property occupancy	Buy-to-let 100%
Weighted-average indexed current LTV ratio (%)	69.02
Weighted-average original LTV ratio (%)	69.21
Average loan size balance (£)	170,205
Loan size range (£)	35,775 to 1,395,787
Weighted-average seasoning (months)	5
Weighted-average asset life remaining (years)	19.0
Weighted-average current mortgage loan interest rate (%)	4.84
Arrears > one-month (%)	0
Redemption profile	Interest only (optional switching to repayment): 26.14% Interest only (mandatory switching to repayment): 59.06% Interest only for life: 8.60% Repayment: 6.21%
Cash reserve (%)§	3 (see explanation in relevant section)
Mortgage loan priority	First-ranking

*Data is based on a provisional pool as of Sept. 30, 2012. §We expect that the cash reserve will not be amortizing when we assign final ratings. LTV--Loan-to value.

Transaction Summary

Standard & Poor's Ratings Services has assigned its preliminary credit ratings to Paragon Mortgages (No.17) PLC's (PM 17) class A, B, and C notes. At closing, PM 17 will also issue unrated class D notes.

Paragon Mortgages (2010) Ltd. (Paragon) is the originator; the Paragon Group Of Companies PLC will act as mortgage administrator through its wholly-owned subsidiary, Moorgate Asset Administration Ltd. Paragon originated all the loans in the pool since 2010, many of which have different features to the loans in earlier Paragon transactions that we have rated.

The transaction will have a prefunding period of six months, during which the proceeds of the notes in excess of the mortgage portfolio balance will be used to purchase new mortgages.

Moorgate Asset Administration will act as the mortgage administrator for all of the loans in the transaction. Homeloan Management Ltd. is the back-up administrator.

Our ratings reflect our assessment of the main features of the transaction, as well as an analysis of the counterparty and operational risks of the transaction.

We incorporated in our analysis all the structural features of the transaction and the results indicate that the levels of credit enhancement available to the tranches are sufficient to mitigate the credit and cash flow stresses to the assigned rating levels.

Notable Features

Paragon, a specialized and experienced buy-to-let lender and servicer, originated a number of transactions before 2007 but stopped originating mortgages between 2008 and 2010. Paragon Mortgages (No.17) will be the first transaction from Paragon that we will rate since 2007, and Paragon's second securitization since it resumed lending in 2010.

The collateral pool consists of first-ranking buy-to-let mortgages originated after 2010.

All of the loans in the pool are currently in their fixed or discount period: Of the loans in the pool, 27.62% pay a fixed rate of interest, and the remaining 72.38% pay at a rate linked to LIBOR.

After the end of the fixed or discount period, all of the loans will either revert to an administered rate, or to a rate linked to LIBOR plus a variable margin, floored at LIBOR + 4.50%.

The transaction does not have a basis risk swap in place, therefore the portion of the pool comprised of loans paying a rate linked to LIBOR, both before and after the reversionary date, will be subject to basis risk, as the LIBOR on the notes re-sets on the 8th day of the month, while the assets re-set on the first day of the month. We have considered this in our analysis.

At closing, the issuer will use part of the proceeds of the notes' issuance to pay purchase price for the pool of loans. It will then deposit the remainder of the proceeds into a pre-funded reserve to purchase new loans from the seller during the following six months from closing. As a result, the credit quality of the pool may change between closing and the end of the six-month prefunding period.

The composition of the pool could change further due to the purchase of further advances during the life of transaction. The addition of new loans and further advances is subject to the satisfaction of a number of conditions specified in the transaction documents. These conditions aim to ensure that the credit quality of the pool does not change dramatically as a result of the addition of new loans and further advances (see "Strengths, Concerns, And Mitigating Factors").

Strengths, Concerns, And Mitigating Factors

Strengths

- In our view, Paragon is an experienced buy-to-let mortgage loan originator and servicer.
- Homeloan Management will act as a back-up servicer for the transaction. We rank Homeloan Management as ABOVE AVERAGE as a mortgage servicer.

- The cash collateralization mechanism guarantees a margin of 375 basis points (bps) over three-month LIBOR on the loans that are in their discount period.
- The transaction documents provide for a minimum mortgage rate (MMR) mechanism, which is intended to help maintain a certain yield on the assets.

Concerns and mitigating factors

- All of the loans in the pool are buy-to-let mortgages. Buy-to-let properties are exposed to different foreclosure risks than owner-occupied properties. These risks include the borrower's level of reliance in the rental receipts to meet mortgage payments and the borrower's prior experience in managing rental properties. We have considered these features in our analysis.
- The credit support at closing provided by the first loss liquidity excess amount (FLLEA) is small. Although it may increase over time subject to available excess spread, most of the credit support for the notes will be provided by subordination and excess spread.
- Some of the loans in the pool will pay a rate of interest linked to three-month LIBOR, either during the discount period, after the switch to the final rate, or during both periods. The LIBOR rate used to determine the mortgage rate for these loans may be lower than the rate used to calculate the coupon in the notes. The resulting basis risk is not hedged in this transaction. We have incorporated this risk in our analysis.
- During the pre-funding period, the quality of the portfolio could deteriorate. However, the conditions set out for the purchase of new loans partially mitigate this risk, which aim to limit the risk of deterioration of the portfolio's quality.
- Loans in the portfolio are of a big size; large loans are secured against properties with larger-than-average valuations. We stressed jumbo valuations in our loss severity analysis because we consider jumbo properties to be less liquid, attracting higher repossession market value declines (RMVDs).
- Half of the final pool, after pre-funding, could comprise of loans which will be interest-only loans for the first five years since their origination, switching to repayment after the initial period. This poses a payment shock risk, as the borrowers' installments will increase in size significantly. We incorporated this risk into our analysis.
- The pool shows a very low level of seasoning. We consider loans with low seasoning as having higher risk than highly seasoned loans because we note that the three initial years of a mortgage represent the most stressful period for a borrower, where most defaults happen.

Transaction Structure

At closing, PM 17 will acquire the beneficial interest in the mortgage loan pool from the seller, Paragon Mortgages (2010) Ltd. PM 17 will issue the class A, B, C, and D notes to fund the purchase of the portfolio.

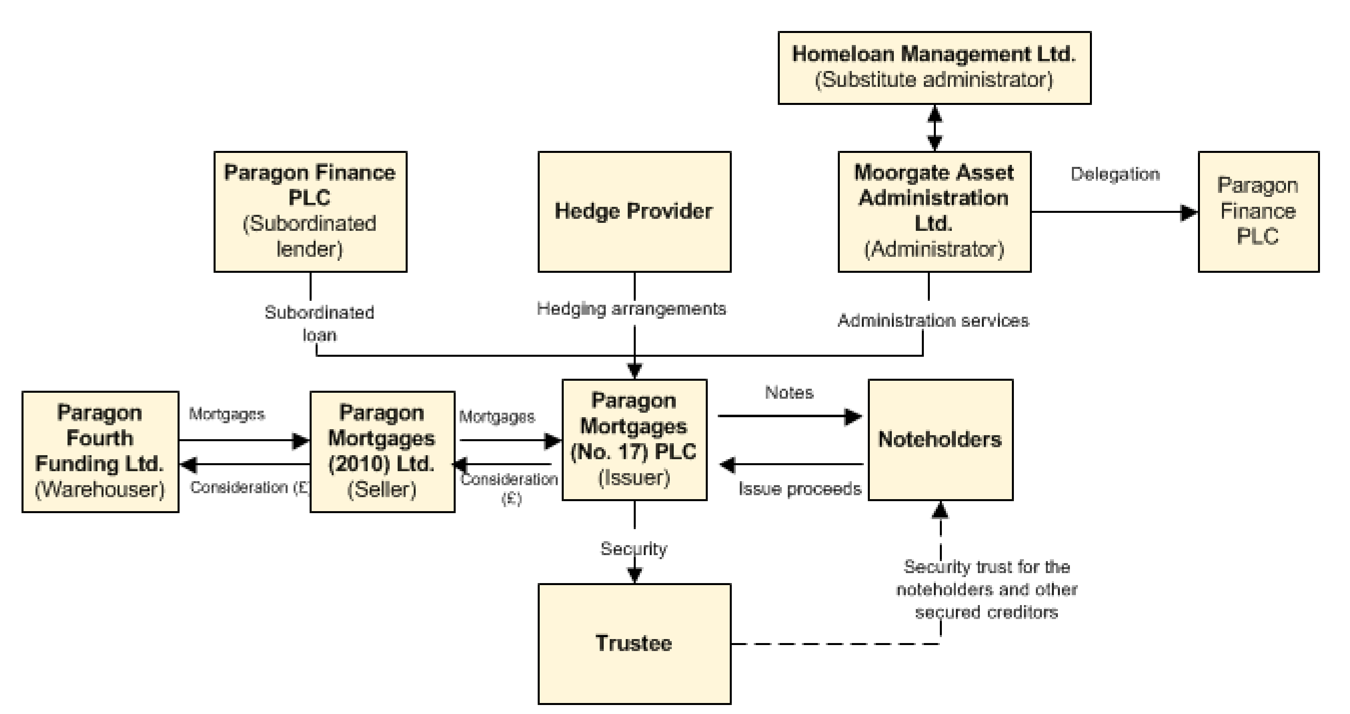
The Paragon group fully owns the issuer's shares, but we have received legal comfort that, if a Paragon group company becomes insolvent, the issuer will not be taken into insolvency. Moreover, the tax opinion gave comfort that the issuer tax group incorporated in the VAT group of Paragon will not result in the issuer being exposed to additional tax pressure, should Paragon be subject to withholding tax.

The issuer will grant security over all of its assets in favor of the security trustee (see chart 1).

Chart 1

Paragon Mortgages (No. 17) PLC

Transaction structure



Seller and portfolio administrators

Paragon Mortgages (2010) Ltd. will act as the seller in this transaction. The Paragon Group Of Companies, through its subsidiary Moorgate Asset Administration Ltd., will act as mortgage administrator. The seller will also hold legal title to the mortgage loans until a perfection of title event occurs.

As a part of our standard corporate overview, we conducted a review of Paragon's origination, underwriting, and valuation processes, as well as its default-management procedures in September 2012. We are satisfied that both Paragon and Homeloan Management are capable of performing their functions in the transaction.

Notes Terms And Conditions

We understand that PM 17 will issue a number of tranches of notes. We show the expected legal maturities of the notes in the opening table.

Interest on the notes will be payable quarterly in arrears on the 8th of January, April, September, and October each year, with the first interest payment date (IPD) on Jan. 8, 2013.

Optional redemption of the notes

The issuer may redeem all the notes at their principal amount outstanding, together with any accrued interest on or after the call date in January 2016.

Mandatory redemption of the notes

The issuer will apply available principal receipts to redeem the notes at each IPD, subject to the principal priority of payments.

Clean-up call

The issuer may redeem all the notes at their principal amount outstanding together with any accrued interest, if the total outstanding balance of the notes is less than 10% of the original balance of all notes at closing.

Amortization of the notes

We expect PM 17 to pay principal receipts sequentially to the noteholders, with the class A notes being redeemed prior to subordinated classes.

Collateral Description

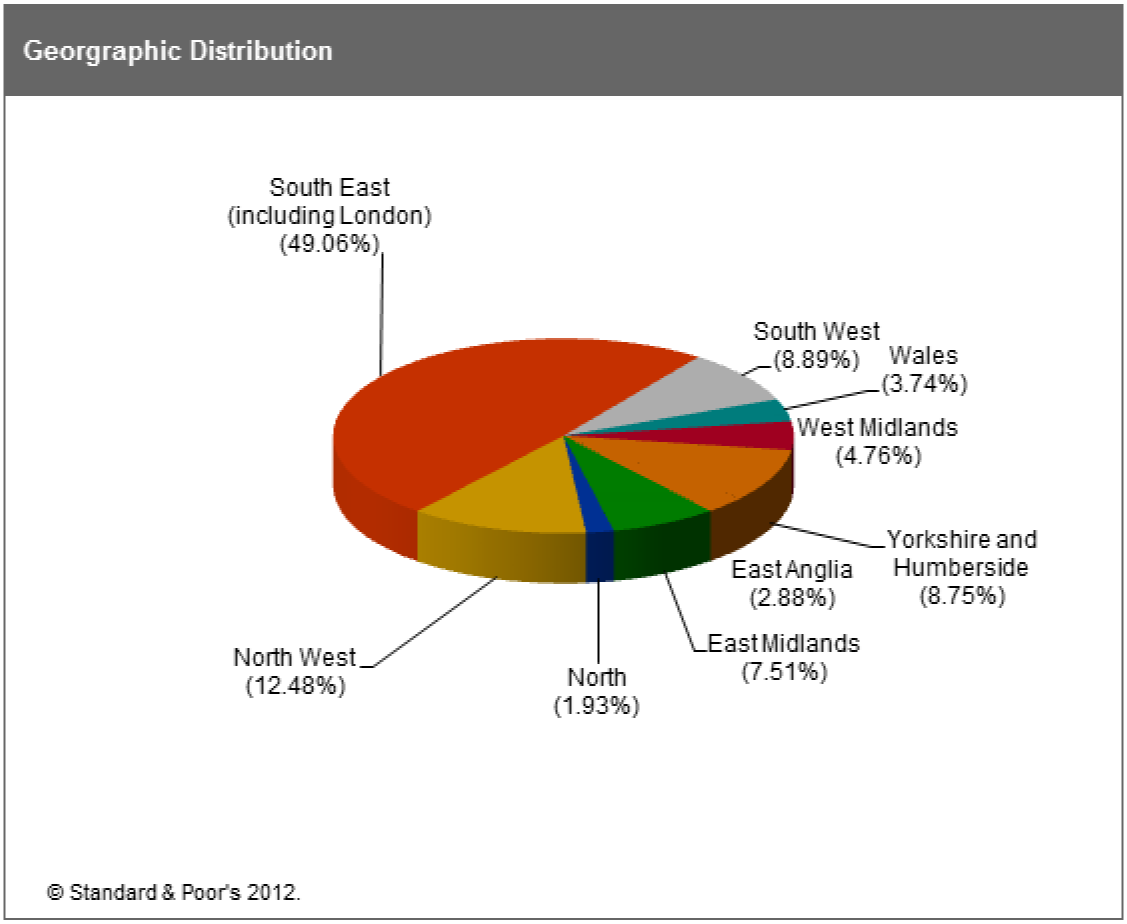
The provisional mortgage loan pool of £140,249,017 comprised 824 loans secured against buy-to-let properties as of Sept. 30, 2012. Paragon has originated all of the loans in the pool since 2010. A specific feature of this pool, which we have not seen in any previous transactions from Paragon that we have rated, is the inclusion of loans that are interest-only for an initial period of five years, following which there is a mandatory switch to repayment. In our view, it is likely that the borrowers who have mortgage loans of this type will try to refinance their loans at the end of interest-only period. However, we recognize that their ability to do so may be limited for various reasons; if they are unable to refinance, they will face substantial increases to their monthly installments. We have adjusted our foreclosure assumptions for these loans to account for this risk of increased payments.

The portfolio has a weighted-average indexed current loan-to-value (LTV) ratio of 69.02%. All borrowers had their rental income verified, all loans in the actual pool are current, and the maximum amount of loans in arrears that can be purchased by the issuer after the closing date, either as prefunded new loans or as further advances, is one million pounds.

The seasoning of the pool is low, as the loans have been recently originated. The weighted-average seasoning is five months. We view loans with low seasoning as exhibiting higher risk profiles than loans with otherwise identical characteristics.

The pool is mainly concentrated in South East England and London (49.06%; see chart 2). However, this concentration is below the level that we consider to be excessive, and we have therefore made no further adjustment for this in our analysis.

Chart 2



The weighted-average current indexed LTV ratio of the collateral is relatively low for a U.K. transaction, at 69.02% (see chart 3). We consider that borrowers with minimal equity in their property are less likely to be able to refinance, and are more likely to default on their obligations than borrowers with lower current indexed LTV ratio loans. At the same time, loans with current indexed high LTV ratios are likely to incur greater loss severities if the borrower defaults. Of the pool, 99.9% of the loans exhibit a current indexed LTV ratio lower than 80%, and 37% have a current indexed LTV ratio below 70%.

Chart 3

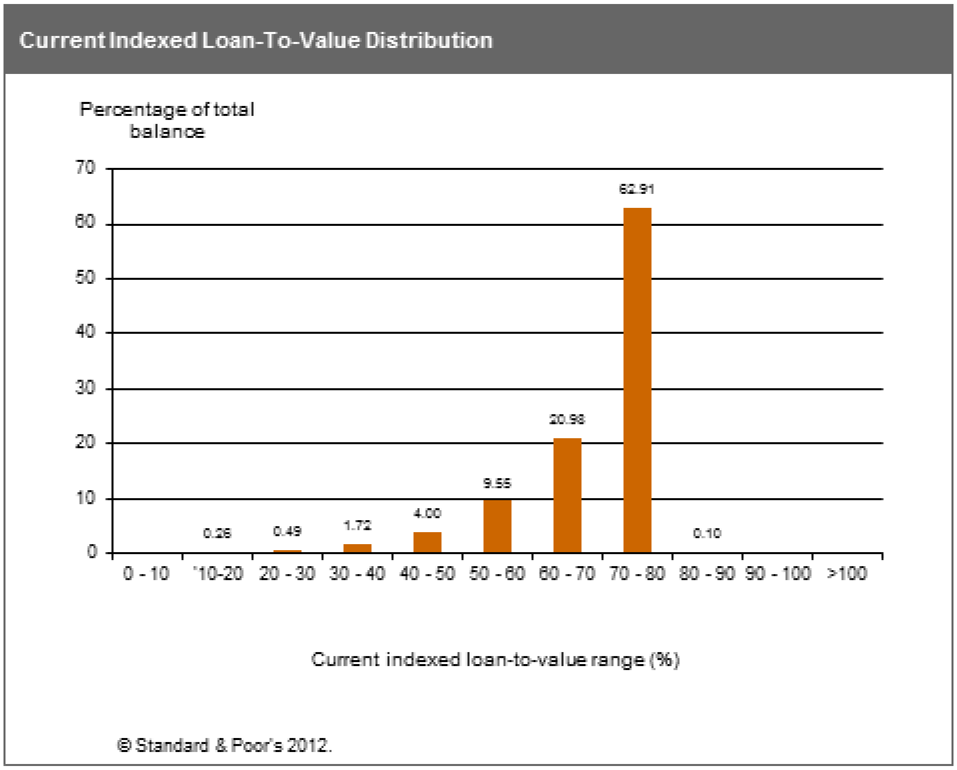
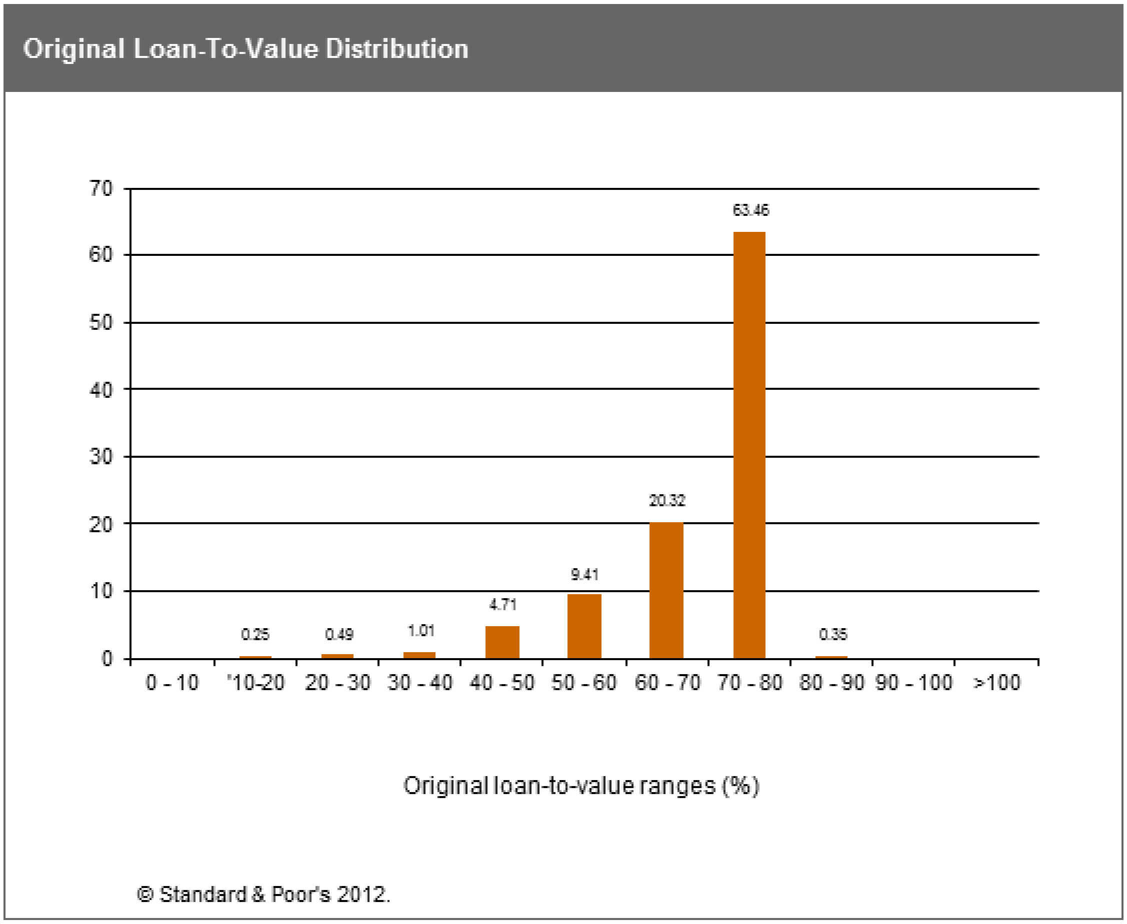
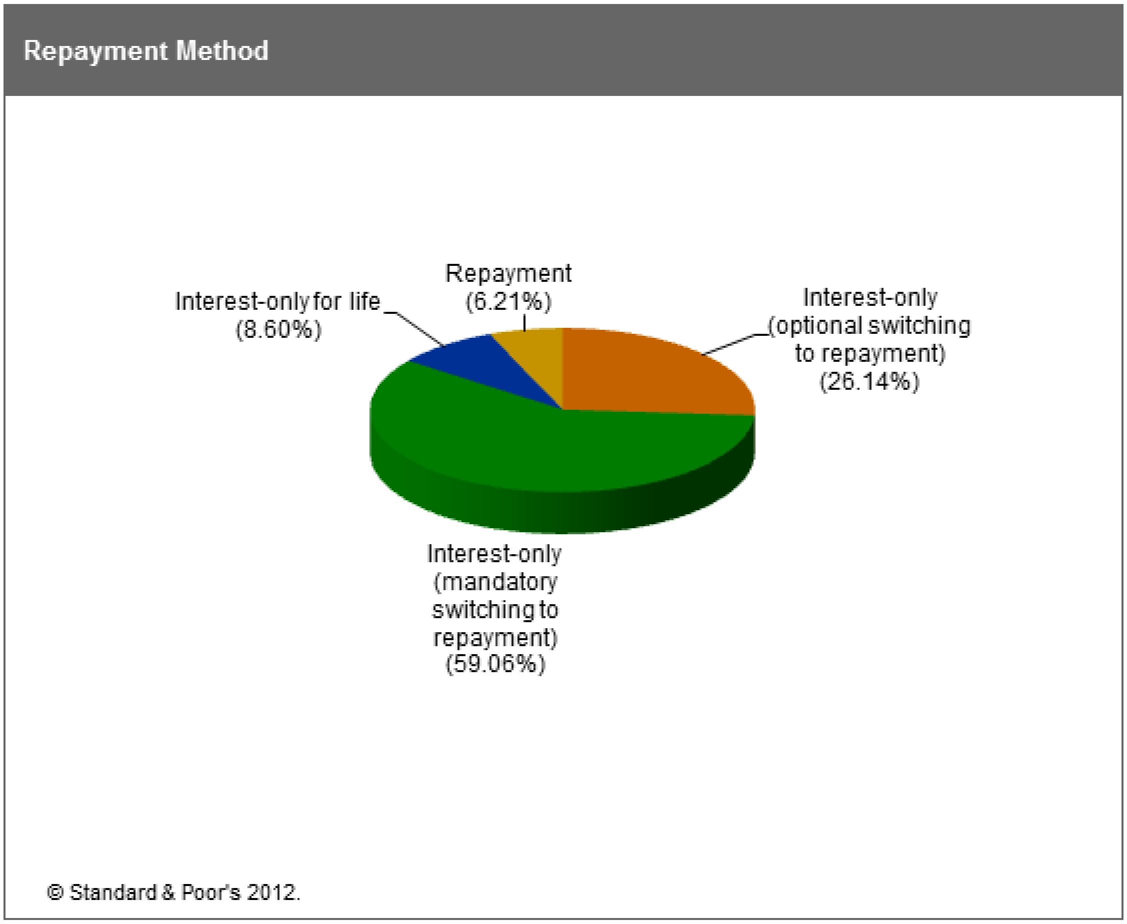

Current Indexed Loan-To-Value Distribution
Percentage of total balance
70
60
50
40
30
20
10
0
62.91
20.98
9.55
4.00
1.72
0.26
0.49
0.10
0 - 10
'10-20
20 - 30
30 - 40
40 - 50
50 - 60
60 - 70
70 - 80
80 - 90
90 - 100
>100
Current indexed loan-to-value range (%)
© Standard & Poor's 2012.

Chart 4



Of the portfolio, 59% consists of the product described in the sections above, and we consider these loans as having the risk of a payment shock when switching to repayment (see chart 5).

Chart 5



Prefunding pool

If all the proceeds of the notes in excess of the actual mortgage pool will be used to purchase new loans, then the prefunding pool will have a total balance of £59.75 million, which corresponds to 29.9% of the total pool of £200 million.

During the first six months after closing the issuer will purchase new loans from the seller, subject to certain criteria designed to control the credit quality of the aggregate pool, for example:

- The aggregate current balance of mortgages in respect of which properties are located in Greater London, South East, South West and East Anglia and have a value greater than £500,000 must be less than 34% of the final pool balance of £200 million.
- The aggregate current balance of mortgages in respect of which properties are not located in Greater London, the South East, South West or East Anglia and have a value greater than £300,000 must be less than 12% of the final pool balance of £200 million.
- The aggregate current balance of interest-only mortgages and optional repayment mortgages that have an original term of 10 years or less must be less than 2 per cent. of the final pool balance.
- The aggregate current balance of Interest-only mortgages switching to repayment in five years must be less than 50

per cent of the final pool balance.

- Based on the current balance of each mortgage, the weighted-average current LTV ratio must not exceed 70.5%.
- The aggregate current balance of mortgages which have a current LTV ratio either equal to or greater than 75% and equal to or less than 79% must be equal to or less than 45% of the final pool balance of £200 million.
- The aggregate current balance of mortgages which have a current LTV ratio either equal to or greater than 70% and equal to or less than 79% must be equal to or less than 65% of the final pool balance.
- The current LTV ratio of any mortgage based on its adjusted current balance must be equal to or less than 79%.
- The aggregate current balance of the mortgage of the top 20 borrowers must not exceed £22.7 million.

Substitutions

If the servicer identifies a loan as being in breach of the representations and warranties of the seller, the seller will be required to repurchase (or substitute) the loan.

Credit Structure

A combination of subordination, the reserve fund, and excess spread on the mortgage loans will provide credit support for the notes (see table 1).

Table 1

Credit Support For The Notes

Class	Prelim. rating	Size of class (%)	Mil. £ (equivalent)	Initial credit support (%)
A	AAA (sf)	87.5	175.0	12.56
B	AA (sf)	5.25	10.5	7.31
C	A (sf)	5.0	10.0	2.31
D	NR	2.25	4.5	0.06

NR--Not rated. N/A--Not available. TBD--To be determined.

PM17 will open two accounts with National Westminster Bank (NatWest; rated A/Stable/A-1) the transaction account and the collection account.

Any accounts will be subject to the terms of the transaction documents. The administrator will replace NatWest in its roles of transaction account bank and seller collection account bank with a suitably rated institution in 60 days, if:

- At any time, we lower our long-term issuer credit rating (ICR) on the account bank (in this case, NatWest) below 'A', where the short-term rating is at least 'A-1'; or
- We lower our long-term ICR on the account bank below 'A+', if it does not have a short-term rating.

Under the transaction documents, the borrowers will make their monthly payments in the seller collection accounts held with NatWest. The transaction documents will establish a declaration of trust over any amounts standing to the seller collection account. Amounts standing to the credit of the collection account will be swept on daily basis into the transaction account.

At any point in time of the deal, the account can be moved to Barclays Bank PLC (A+/Negative/A-1) if Barclays is considered to be an eligible institution under our counterparty criteria in effect at the time of transfer, and if the bank accepts the same contractual terms previously agreed with NatWest.

First loss fund

The first loss fund (FLF) will be non-amortizing and funded at closing to 3% of the initial notes balance. In the FLF ledger, an amortizing amount equal to 3% of the rated notes outstanding will represent the liquidity amount and only the difference between the FLF and the liquidity amount will form the first loss liquidity excess (FLLEA) which will be available to cure credit losses, whereas the liquidity amount will provide only liquidity support to the rated notes.

The amount available to cure losses, at inception, through the FLLEA is just six bps, but, when notes start to amortize, we expect the FLLEA to increase in size, following the amortization of the liquidity amount, with more credit enhancement being available to the tranches.

The required amount of the FLF will increase to 4% if:

- 60+ day arrears are more than 3% of the current balance of the mortgages in the portfolio; or
- Cumulative losses are equal or greater than 2% of the original balance of the notes.

The issuer will replenish the reserve FLF from excess spread, if available, and principal receipts.

Margin reserve fund and cash collateralization

At closing, the seller will calculate for each loan an amount equal to the difference between 375 bps and the actual margin earned on each loan (including the post-swap margin in case of a fixed-rate loan) applied to the outstanding balance of the loan at closing and for the duration of the fixed or tracker period. The seller will deposit the aggregate of these amounts for each loan in the margin reserve fund (MRF) held by the issuer.

This purpose of this mechanism is to ensure that the margin on the assets during their discount period is equal to at least 375 bps. The amount deposited in the MRF will be released on each IPD according to a predefined schedule, irrespective of whether any of the borrowers is delinquent.

At closing, the seller will also deposit in the MRF the amount equal to the difference between the yield earned on the cash held in the pre-funding reserve and LIBOR+3.75% during the prefunding period. This amount will be released and become part of issuer's revenue funds in the first two IPDs.

Minimum mortgage rate mechanism

The loans in the pool are either currently fixed- or floating-rate at LIBOR plus a margin. After the end of fixed or tracker period, half of the pool reverts to the administered rate, while the other half of the pool reverts to contractual rate of three-month LIBOR plus 450 bps. Paragon can increase this margin further.

For the loans in administered rate the administrator will have the ability to vary the rate of interest on a loan-by-loan basis, however the administrator will undertake in the administration agreement to set the rate of interest at a level sufficient to ensure that the average yield on the entire pool plus any other income that the issuer receives from any hedging agreements or any releases from MRF will be no lower that minimum mortgage rate (MMR). The MMR is set at three-month LIBOR plus 4.0% for the first five years and thereafter three-month LIBOR plus 4.5%. The three-month LIBOR used in the calculation of MMR is the 3-month LIBOR used to determine the coupon on the bonds for each quarterly period.

If the administrator decides to set the rates on the mortgages below a level sufficient to maintain the MMR, it will have to post an amount equal reflecting the difference into the shortfall fund.

If Paragon in its role as administrator is replaced, the obligation of setting the rates on the pool in order to guarantee the MMR, will pass onto the trustee and then to the subsequent administrator.

Since the rate can be adjusted only once the loans have reverted to the administered rate, the ability of the administrator to maintain the MMR may be limited during the period when large portion of the loans are still in their fixed or tracker period, in our view. We have taken this limitation into account for our cash flow analysis.

Principal to pay interest

PM 17 can use principal to pay interest if other revenue sources are insufficient for this purpose. If this occurs, the balance would be recorded to the PDL and may reduce the credit enhancement available to the notes. However, the issuer can only use principal to pay interest on notes other than the class A notes if the PDL of the relevant class does not become more than 50% of the tranche's size and 100% of all classes of notes ranking junior to it.

Priority of payments

The revenue priority of payments will be as follows:

- Senior fees;
- Swap payment;
- Class A interest;
- A PDL;
- Class B interest;
- B PDL;
- Class C interest;
- C PDL;
- D PDL;
- FLF top-up; and
- Subordinated payments (including the class D notes' interest, sub loan interest and swap defaulted termination payments).

The principal priority of payments will be as follows:

- Top up liquidity amount (part of the FLF) if required;
- Further advances;
- Class A principal;
- Class B principal;
- Class C principal;
- Class D principal; and
- Subordinated loan principal.

Principal deficiency ledger

The PDL will comprise four sub-ledgers, the class A notes' PDL, the class B notes' PDL, the class C notes' PDL, and the class D notes' PDL. Losses (or use of principal receipts and LA) will first be allocated to the PDL in reverse order of seniority with the class D PDL being debited first.

Further advances

The transaction allows for both mandatory and discretionary further advances to be granted.

While the undrawn amounts of the mandatory further advances represent only 0.28% of provisional pool balance, the structure allows the issuer to purchase discretionary further advances in the amount up to 8% on the original balance of the notes, subject to having sufficient funds to do so. The addition of further advances is subject to the same conditions that we described above in relation to the purchase of prefunded loans.

Hedging Risk

Fixed-to-floating swap

The issuer will enter into a number of fixed-to-floating swaps with Macquarie Bank Ltd. Under the swaps, the issuer will pay a fixed-rate in exchange for the three-month LIBOR that is used to determine the coupon on the notes.

The notional of the swap at closing will roughly correspond to the balance of fixed-rate loans and will change over the first six months of the transaction to reflect the potential addition of fixed-rate mortgage loans to the pool.

The notional of the swap will reduce to zero in three years' time and will amortize following a predefined schedule regardless of the prepayments or defaults on the fixed-rate loans.

Credit And Cash Flow Analysis

We stress the transaction's cash flows to test the credit and liquidity support that the assets, subordinated tranches, and cash reserve provide.

We apply these stresses to the cash flows at all relevant rating levels. For example, this transaction incorporates tranches that we rate 'AAA' and 'NR' (not rated). We therefore apply one set of cash flow stresses. In our stresses on the 'AAA' rated notes, all notes must pay full and timely principal and interest. However, this is not necessarily the case for the tranches of unrated notes because they are subordinated in the priority of payments.

Credit enhancement

The 'B' credit enhancement level for the standard U.K. mortgage loan pool is commensurate with our current assumptions of expected losses on that pool (see "U.K. RMBS Methodology And Assumptions," published on Dec. 9, 2011). These expected losses vary according to changes in the outlook for the U.K. mortgage market and cover macroeconomic factors such as unemployment, inflation, and current mortgage performance, among other factors. The current 'B' level of credit enhancement includes a foreclosure frequency component for the standard U.K. mortgage loan pool, as shown in table 2. We used the assumptions in table 5 as part of our credit analysis of the underlying assets in this transaction.

Table 2

Assumptions	
Rating level	**Base foreclosure frequency component for an archetypical U.K. mortgage loan pool (%)**
AAA	12.0
AA	8.0
A	6.0
BBB	4.0
BB	2.0

Amount of defaults and recoveries

We model the foreclosure frequency for each loan in the pool, as well as the amount of loss upon the subsequent sale of the property (the loss severity, expressed as a percentage of the outstanding loan). We model a default of the total mortgage loan balance. We determine the total amount of the unrecovered defaulted balance for the entire pool by calculating the weighted-average foreclosure frequency (WAFF) and the weighted-average loan severity (WALS). When comparing the minimum credit enhancement levels that we consider commensurate with each rating level with that of this pool, we also included interest foregone between the point of default and the receipt of recoveries (see table 3).

Table 3

Assumptions		
Rating level	**Minimum credit enhancement level (%)**	**Initial credit enhancement modeled for this pool (%)**
AAA	4.0	12.56
AA	2.5	7.31
A	1.5	2.31

The WAFF and the WALS increase in tandem with the rating level because notes with a higher rating should be able to withstand a higher level of mortgage default and loss severity. Our credit analysis is based on the characteristics of the loans and the associated borrowers, as well as our subsequent assessment of the WAFF and the WALS for this portfolio, which were the inputs that we used in our cash flow analysis (see table 4).

Table 4

Portfolio WAFF, WALS, And Credit Enhancement			
Rating level	**WAFF (%)**	**WALS (%)**	**Credit enhancement (%)**
AAA	30.32	40.04	12.14
AA	21.74	34.34	7.47
A	17.37	23.90	4.15

WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loan severity.

For modeling purposes, the repossession market value declines we apply as per our criteria to calculate the loss severity incorporate our calculation of the degree of over- or under-valuation for each specific region of the U.K. (see "U.K. RMBS Methodology And Assumptions," published on Dec. 9, 2011). The resulting market value declines that we used in our analysis of this pool are shown in table 5.

Table 5

Repossession Market Value Declines At 'AAA', 'AA', And 'A' Rating Levels			
Region	**AAA (%)**	**AA (%)**	**A (%)**
East Anglia	50.6	47.0	39.9
East Midlands	49.0	45.6	38.7
North	46.7	43.7	37.2
North West	48.4	45.1	38.3
Northern Ireland	43.5	40.6	34.2
Scotland	44.2	41.3	34.9
South East (including London)	52.6	48.7	41.3
South West	54.7	50.5	42.8
Wales	49.5	46.1	39.1
West Midlands	49.1	45.7	38.8
Yorkshire and Humberside	45.3	42.3	35.9

Timing of defaults

At each rating level, the WAFF specifies the total balance of the mortgage loans we assume to default over the life of the transaction. We model these defaults to occur over a three-year recession. Further, we test the effect of the timing of this recession on the ability to repay the liabilities by starting the recessionary period at closing, year 1, year 2, and year 3.

We apply the WAFF to the principal balance outstanding at the closing date. We model defaults to occur periodically, in amounts calculated as a percentage of the WAFF. The timing of defaults follows two paths, referred to as "front-loaded" and "back-loaded" (see table 6).

Table 6

Default Timings For Front-Loaded And Back-Loaded Default Curves		
Recession month	**Front-loaded defaults (percentage of WAFF per month)**	**Back-loaded defaults (percentage of WAFF per month)**
1–6	5.0	0.8
7–12	5.0	0.8
13–18	3.3	1.7
19–24	1.7	3.3
25–30	0.8	5.0
31–36	0.8	5.0

WAFF--Weighted-average foreclosure frequency.

Timing of recoveries

We assume that the issuer regains any recoveries 18 months after a payment default for owner-occupied properties. The value of recoveries at each rating level is 100%, minus the WALS for that rating level.

The WALS we use in the cash flow model is based on principal loss, including foreclosure costs. We do not give credit for the recovery of any interest accrued on the mortgage loans during the foreclosure period. After we apply the WAFF to the balance of the mortgage loans, we find that the asset balance is likely to be lower than that of the liabilities. Our test shows that the interest reduction caused by the defaulted mortgage loans during the foreclosure period is covered by the other structural mechanisms of the transaction.

Delinquencies

We model the liquidity stress that results from short-term delinquencies (those mortgage loans that cease to pay for a period of time, but then recover and become current with respect to both interest and principal). To simulate the effect of delinquencies, we model a proportion of scheduled collections equal to one-third of the WAFF to be delayed. We apply this in each of the first 18 months of the recession, and model full recovery of these delinquencies to occur 36 months after they arise. Therefore, if the total scheduled collateral collections expected to be received is £1 million and the WAFF is 30% in month five of the recession, £100,000 (one-third of the WAFF) is delayed until month 41.

Interest and prepayment rates

We model five different interest rate scenarios—up, down, up-down, down-up, and forward curve. We model three prepayment scenarios at all rating levels—high, low, and forecast. For this transaction, we modeled the forecast constant payment rate (CPR) as 4%. During the recessionary period, we model the prepayment rate at 3%, before gradually reverting to a high prepayment rate under both scenarios. At the 'AA' level and above, we model an additional low prepayment scenario, which also reverts to a low prepayment rate after the recession period.

In combination, the default timings, recession timings, interest rates, and prepayment rates described above give rise to 240 different scenarios at a 'AAA' rating level (see table 7). The ratings we assign mean that the notes have all paid timely interest and ultimate principal under each of the scenarios at the assigned rating level.

Table 7

RMBS Stress Scenarios

Rating level	Total number of scenarios	Prepayment rate	Recession start	Interest rate	Default timing
'AAA'	60	High, expected, and low	Closing, years 1, 2, and 3.	Up, down, up-down, down-up, forward for standard run.	Front-loaded and back-loaded
'AA-' and below	40	High and low	Closing, years 1, 2 and 3.	Up, down, up-down, down-up, forward for standard run	Front-loaded and back-loaded

Scenario Analysis

Various factors could lead us to lower our ratings on the notes, such as increasing foreclosure rates in the underlying pool, and changes in the pool composition. We have analyzed the effect of increased delinquencies by testing the sensitivity of the ratings to two different levels of movements.

Increasing levels of delinquencies will likely cause more stress to a transaction, and would likely be a contributing factor in the downgrade of rated notes.

In our analysis, our assumptions for the increase in delinquencies are specific to a transaction, although these levels may be similar (or the same) across different transactions. The levels do not reflect any views as to whether these deteriorations will materialize in the future; however, our analysis already incorporates additional adjustments to the default probability of the pool by projecting buckets of expected arrears.

Note that even under these scenarios, structural features in securitizations may mitigate these deteriorations in performance.

Further delinquencies of 8%

In the first scenario, in addition to the rating-dependent stress assumptions, we apply a further 8% increase in nonperforming loans. These are split equally between the one-month and three-month buckets. In the second scenario, we apply an increase of 8%, but all the loans are deemed to have missed three monthly payments. The default probability we assign to a loan increases in tandem with the monthly payments missed. As a consequence, assuming that all loans have missed three monthly payments, the increase in the WAFF would be greater in the second scenario.

Tables 8 and 9 summarize the results of assuming increasing levels of delinquencies.

Table 8

Assuming An Additional 8% Of Arrears, Split Equally Between One Monthly Payment And Three Monthly Payments Missed

Rating on the notes	WAFF (%)	WALS (%)
AAA	35.32	40.04
AA	25.74	34.34
A	20.17	23.9

Table 9

Assuming An Additional 8% Of Arrears, All Of Which Have Missed Three Monthly Payments

Rating on the notes	WAFF (%)	WALS (%)
AAA	38.32	40.04
AA	27.74	34.34
A	21.37	23.9

Under the first scenario, the ratings on the notes in the transaction would not suffer a ratings transition of more than one level (for example, the 'AAA' rated notes would achieve a rating of at least 'AA').

Under the second scenario, the ratings on the notes would not suffer a rating transition of more than two levels (for example, the 'AAA' rated notes would achieve a rating of at least 'BBB').

Under scenario one, the class A notes pass at a 'AA+' rating level, the class B notes pass at a 'AA-' rating level, and the class C notes pass at a 'A-' rating level.

Under scenario two, the class A notes pass at a 'AA+' rating level, the class B notes pass at a 'A+' rating level, and the class C notes pass at a 'BBB+' rating level.

It should be noted that we based the analysis above on a simplified assumption, i.e., that the increase in arrears materializes immediately on the day after closing. In reality, these are likely to occur over a period of time. Therefore, other factors, such as seasoning or repayments of some loans, could partially mitigate the effect of deteriorating performance of other loans.

Sectoral Credit Highlights

The U.K. remains in recession as GDP decreased by 0.7% in Q2 2012, following two successive quarters of decline. Unemployment fell only slightly in the quarter to May 2012, although it remains to be seen if this will continue as the economy contracts. We consider unemployment to be highly correlated with delinquencies and view future changes in this statistic as crucial to borrower performance.

According to the Nationwide index, U.K. house prices have decreased in Q3 2012 by 0.5%. Both the Nationwide and the Halifax indices continue to show small declines for 2012 as a whole. Demand is still low, as first-time buyers struggle to obtain affordable mortgage finance. However, the introduction of the government's Funding for Lending Scheme on Aug. 1, 2012, could alleviate this by cutting bank funding costs in exchange for lending to companies and households. The scheme aims to provide access to cheaper loans for small and midsize enterprises (SMEs), stimulating a recovery in capital spending. Further, a fall in mortgage rates after a steady rise from the beginning of 2012 could increase lending for house purchases and the remortgage market.

The Bank of England maintained the base rate at 0.5% in July 2012. It also agreed to a further £50 billion of quantitative easing to fuel economic activity. The low interest rate environment continues to benefit borrower affordability.

The fall in the consumer price index's annual inflation remained relatively flat in August 2012 at 2.5%; this compares to 2.4% in June and provides some respite to borrowers, but wage inflation is still stubbornly low, currently below 2.0%. As a result, the cost of living continues to outpace pay increases, which affects borrowers' ability to meet their mortgage payments.

We expect collateral performance to remain stable overall for the remainder of 2012, but the downside risks in the wider economy could affect performance.

Surveillance

We will maintain surveillance on the transaction until the notes mature or are otherwise retired. To do this, we will analyze regular servicer reports detailing the performance of the underlying collateral, monitor supporting ratings, and make regular contact with the servicer to ensure that it maintains minimum servicing standards and that any material changes in the servicer's operations are communicated and assessed.

The key performance indicators in the surveillance of this transaction are:

- Increases in credit enhancement for the notes;
- Total and 90-day delinquencies;
- Cumulative realized losses;
- LTV ratios;
- Constant prepayment rates; and
- Increases in the seasoning of the collateral pool.

Standard & Poor's 17g-7 Disclosure Report

SEC Rule 17g-7 requires an NRSRO, for any report accompanying a credit rating relating to an asset-backed security as defined in the Rule, to include a description of the representations, warranties and enforcement mechanisms available to investors and a description of how they differ from the representations, warranties and enforcement mechanisms in issuances of similar securities.

The Standard & Poor's 17g-7 Disclosure Report included in this credit rating report is available at: http://standardandpoorsdisclosure-17g7.com/1036.pdf.

Related Criteria And Research

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