

# Paragon Mortgages (NO.19) PLC

## Presale

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### Capital Structure

Class	Rating	Outlook	Amount (GBPm)	CE <sup>c</sup> (%)	Final Maturity	TT <sup>a</sup> (%)	TTLM <sup>b</sup>
A	AAAsf	Stable	TBD	10.56	Aug 2041	89.5	66.3
B	AAAsf	Stable	TBD	6.06	Aug 2041	4.5	3.3
C	A+sf	Stable	TBD	2.06	Aug 2041	4.0	3.0
D	NR	n.a.	TBD		Aug 2041	n.a.	n.a.
<b>Total Issuance</b>			TBD				

Expected ratings do not reflect final ratings and are based on information provided by the issuer as of 31 January 2014. These expected ratings are contingent on final documents conforming to information already received

<sup>a</sup> Tranche thickness percentage - ratio of class size to collateral balance

<sup>b</sup> Tranche thickness loss multiple - TT% divided by Fitch's base case loss expectation. See also *Structured Finance Tranche Thickness Metrics*, 29 July 2011

<sup>c</sup> Credit enhancement - The actual credit enhancement could be different from that modelled and the final capital structure will be assessed before assigning final ratings

### Transaction Summary

Fitch Ratings has assigned expected ratings to the residential mortgage-backed notes issued by Paragon Mortgages (No.19) PLC (PM19), an SPV incorporated in England and Wales. Fitch expects the final pool of loans backing the notes at the end of the pre-funding period to consist of 80.7% UK prime buy-to-let (BTL) residential mortgages originated by Paragon Mortgages (2010) Limited (Paragon) and 19.3% BTL and owner-occupied mortgages originated or acquired by Mortgage Trust Limited (MTL).

Paragon and MTL (together the sellers) are wholly owned by Paragon Group plc. The MTL-originated loans are in the First Flexible 4 (FF4) transaction and Fitch expects them to be called just after the PM19 closing date of and sold to the PM19 transaction. The loans are serviced by Paragon Finance plc as delegated by the administrators, Paragon Mortgages (2010) Limited and Mortgage Trust Services Plc, with Homeloan Management Limited (HML) acting as back-up servicer.

### Key Rating Drivers

**Buy-to-Let Predominant:** About 97.9% of the portfolio consists of BTL loans. Fitch continues to stress the portfolio's default rates beyond those of a prime owner-occupier portfolio at all rating levels, despite the historically lower arrears of past Paragon deals..

**Pre-Funding Period:** Up to GBP75.0m of additional Paragon-originated loans will be added by the first principal determination date, 31 July 2014. Any balance remaining to the credit of the pre-funding ledger after this period, not used to purchase additional loans, will be used to pay down the notes sequentially. Fitch has run analysis based on expected pool composition at the first principal determination date, which it expects to be 80.7% Paragon-originated loans and 19.3% MTL loans.

**MTL Loans Performing Well:** The MTL loans are part of the Fitch-rated FF4 transaction. The loans have performed strongly, with low arrears. The pool is well seasoned, at over 150 months. Fitch considers the good performance favourably, and has given this benefit in its analysis.

**Counterparty Rating Trigger Risks:** The rating triggers for the issuer account bank, qualified investments, collection account bank and derivative counterparties in the transaction documents have specific reference to Fitch criteria. This creates a degree of uncertainty regarding future counterparty arrangements (see *Counterparty Risk* below for further details).

### Related Presale Appendix

[Paragon Mortgages \(No.19\) PLC](#)

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## Key Parties

**Issuer:** Paragon Mortgages (No.19) plc

**Originator:** Paragon Mortgages (2010) Limited and Mortgage Trust Limited

**Seller:** Paragon Mortgages (2010) Limited and Mortgage Trust Limited

**Servicers:** Paragon Finance PLC (as delegated by the administrators, Paragon Mortgages (2010) Limited and Mortgage Trust Services Plc)

**Back-up Servicer:** Homeloan Management Limited (RPS2)

**Administrators:** Paragon Mortgages (2010) Limited and Mortgage Trust Services Plc

**Trustee:** Citicorp Trustee Company Limited

**Subordinated Lender:** Paragon Finance PLC

**Transaction Account Bank:** Barclays Bank plc (A/Stable/F1)

**Collection Account:** Barclays Bank plc (A/Stable/F1)

**Principal Paying Agent:** Citibank, N.A., London Branch (A/Stable/F1)

**Swap Providers:** Macquarie Bank Limited (A/Stable/F1) and Lloyds Bank plc (A/Stable/F1)

**Arrangers:** Lloyds Bank plc and Macquarie Bank Limited

**Joint Lead Managers:** Lloyds Bank plc, Macquarie Bank Limited and Morgan Stanley & Co. International plc

## Related Criteria

[EMEA Residential Mortgage Loss Criteria \(June 2013\)](#)

[EMEA Criteria Addendum - United Kingdom - Mortgage Loss and Cash Flow Assumptions \(August 2012\)](#)

[EMEA RMBS Master Rating Criteria \(June 2013\)](#)

[EMEA RMBS Cash Flow Analysis Criteria \(June 2013\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds \(May 2013\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum \(May 2013\)](#)

[Criteria for Servicing Continuity Risk in Structured Finance \(July 2013\)](#)

[Representations, Warranties, and Enforcement Mechanisms in Global Structured Finance Transactions \(April 2012\)](#)

[Structured Finance Tranche Thickness Metrics \(July 2011\)](#)

## Rating Sensitivity<sup>1</sup>

This section of the report provides an insight into the model-implied rating sensitivities to hypothetical changes in defaults and/or recoveries on the assets in a stressed environment. These increased defaults and/or recoveries on assets are relative to the dynamic weighted average frequency of foreclosure (WAFF) of the mortgage portfolio (21.62% for the 'AAAsf' rating scenario) and the dynamic weighted average recovery rate (WARR) of the mortgage pool (47.13% for the 'AAAsf' rating scenario), respectively; they are assumed to occur immediately after closing of the transaction. The model-implied rating sensitivities, based on such assumptions, are only indicative of some of the potential outcomes and do not consider other risk factors to which the transaction is exposed.

### Rating Sensitivity to Defaults

	Class A	Class B	Class C
Original rating	AAAsf	AAsf	A+sf
15% increase in default rates	AA+sf	AA-sf	Asf
30% increase in default rates	AAsf	A+sf	A-sf

Source: Fitch

### Rating Sensitivity to Recovery Rates

	Class A	Class B	Class C
Original rating	AAAsf	AAsf	A+sf
15% decrease in recovery rates	AA+sf	AA-sf	Asf
30% decrease in recovery rates	AA+sf	A+sf	A-sf

Source: Fitch

### Rating Sensitivity to Shifts in Multiple Factors

	Class A	Class B	Class C
Original rating	AAAsf	AAsf	A+sf
15% increase in default rates, 15% decrease in recovery rates	AAsf	A+sf	A-sf
30% increase in default rates, 30% decrease in recovery rates	A+sf	A-sf	BBBsf

Source: Fitch

## Model, Criteria Application and Data Adequacy

Fitch analyses the collateral for UK residential transactions using a country-specific, loan-by-loan mortgage default model. The model subjects the mortgage loans to stresses based on Fitch's assessment of historical house price movements and mortgage defaults in the UK. The agency's study showed that a borrower's loan-to-value ratio (LTV), reflecting the size of their down-payment and their willingness to pay, and a borrower's debt-to-income (DTI) ratio or income multiple, reflecting their ability to pay, to be the key determinants of default probability in the UK.

Paragon provided Fitch with a loan-by-loan data template, cumulative loan book losses, and 90+ arrears data. Fitch considers that the data available for the analysis is of good quality.

An Agreed Upon Procedures report (AUP) from an internationally recognised auditing firm verifying data accuracy is expected to be provided to Fitch.

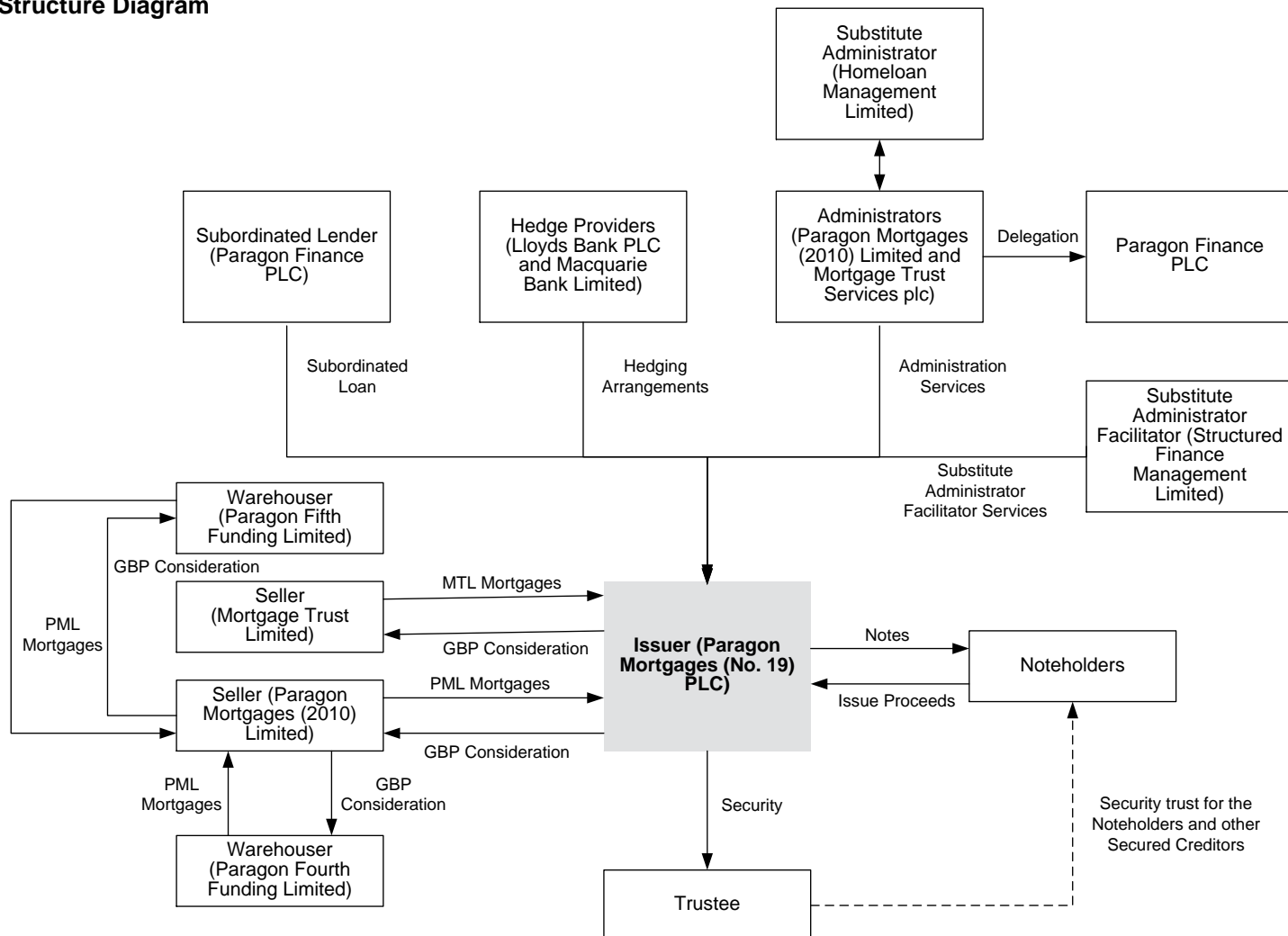
The collateral review of the mortgage portfolio also involves reviewing loan-by-loan loss severity information on the originator's sold repossessions, during which the agency determines the originator's experienced loss severity rate and quick sale discount (QSA). The QSA, calculated using the repossession data provided by the originators, was about 36% for the Paragon loans and 32% for MTL loans. As the QSA figures are higher than Fitch's criteria

<sup>1</sup> These sensitivities only describe the model-implied impact of a change in one of the input variables. This is designed to provide information about the sensitivity of the rating to model assumptions. It should not be used as an indicator of possible future performance

assumption of 22%, Fitch has increased the assumptions for the QSA to 36% for the Paragon portion of the pool and 32% for the MTL portion.

To determine the levels of credit enhancement needed to support the ratings, Fitch simulated the transaction's cash flows using a model incorporating its cash flow stresses.

## Structure Diagram



Source: Transaction documents

## Transaction and Legal Structure

### Legal Framework

On or about the closing date, the sellers will assign the rights, title and interest in and to the mortgages to PM19 (a public company incorporated under the laws of England and Wales). There will be no recourse to the sellers (except with respect to loans sold in breach of warranty) so that the transfer to PM19 is treated as a true sale.

At closing, PM19 will enter into a deed of charge, creating security over its assets in favour of the trustee as security for all payments under the notes. The security will include first-ranking sub-mortgages and first-ranking fixed charges in favour of the trustee over all the issuer's rights, claims, title, benefit and interest in and to the underlying collateral.

The transaction structure is designed to ensure that seller insolvency would not interrupt the timely payment of principal and interest on the notes to investors. The sellers will assign their rights, title and interests in and to the mortgages to the issuer. There will be no recourse to either Paragon or MTL as the sellers of the mortgages; the transfers are treated as a true sale.

The transaction has a pre-funding period in which Paragon may sell further loans to PM19, subject to certain conditions, including:

- a certificate of a director of Paragon confirming that the additional mortgages were originated in accordance with the Paragon Mortgages (2010) Limited lending guidelines;
- no enforcement notice has been served on the issuer;
- no event of default of the notes has occurred; and
- each of the mortgage condition tests mentioned in the transaction documents are satisfied.

### Representations and Warranties

The mortgage sale agreement contains representations and warranties (R&Ws) given by the originators in relation to the pool of mortgages. No search of title has been conducted by the issuer or the trustee; rather they have relied on such R&Ws. If there is an irremediable breach of any of the R&Ws, the seller will be required to repurchase the loan(s) in question.

Specifically, the representations and warranties include the following:

- Each mortgage is secured on a freehold or leasehold residential, or mixed commercial/residential property situated in England or Wales.
- No lien or right of set-off exists between the mortgagee and any borrower.
- No mortgage is or will be repayable later than 31 July 2039.
- No obligation to make a further advance if a borrower is in breach of mortgage conditions.
- As at the relevant purchase date, the maximum aggregate principal amount of all arrears mortgages which may be purchased by the issuer is GBP1,000,000.

One of the sellers (Paragon Mortgages (2010) Limited) is a standalone vehicle, and as such, has limited resources available to repurchase any mortgage receivables that breach the R&Ws given to the issuer. While this framework is weaker than for other UK Prime RMBS transactions, below are a number of mitigating factors which provides comfort to Fitch that the likelihood of substantial breaches of R&Ws is remote.

1. The AUP report that is to be conducted to check for data accuracy, which will be provided to Fitch
2. Fitch performed an enhanced file review to check the quality of originations. This enhanced review resulted in 3x the number of files being reviewed than with a standard originator review.
3. Paragon has a long track record of Fitch-rated transactions. Paragon confirmed that across all transactions till date there has only been one instance of a loan having to be repurchased due to breach of R&Ws.

As a result of these factors, Fitch has not made any adjustments to its analysis with respect to the R&Ws.

### Further Advances

Discretionary further advances may be agreed and advanced to borrowers in the pool by, and at the discretion of, the administrator (acting on behalf of the issuer) using principal receipts or recoveries, provided that, among others:

- there was no debit balance on the principal deficiency ledger (PDL) as at the previous interest payment date;
- the reserve fund is at its required amount;
- the WA current LTV of the portfolio would not increase in value by more than 1% after utilising the pre-funding;

- arrears over three months do not exceed 2% of the then-outstanding balance of the pool;
- each of the mortgage condition tests was satisfied;
- discretionary further advances for MTL loans do not exceed 10% of initial balances of the MTL loans; and
- minimum interest rate for discretionary further advances is three-month sterling Libor, one-month sterling Libor, or Bank of England Base Rate (as applicable), plus 4.50%.

### Disclaimer

For the avoidance of doubt, Fitch relies, in its credit analysis, on legal and/or tax opinions provided by transaction counsel. As Fitch has always made clear, Fitch does not provide legal and/or tax advice or confirm that the legal and/or tax opinions or any other transaction documents or any transaction structures are sufficient for any purpose. The disclaimer at the foot of this report makes it clear that this report does not constitute legal, tax and/or structuring advice from Fitch, and should not be used or interpreted as legal, tax and/or structuring advice from Fitch. Should readers of this report need legal, tax and/or structuring advice, they are urged to contact relevant advisers in the relevant jurisdictions.

### Asset Analysis

#### Lender Adjustment

Fitch's base default probabilities assume that origination, underwriting and servicing practices and procedures are in line with those of a standard traditional UK mortgage lender with market expertise, financial stability and relevant management experience.

As part of the analysis, the agency performs an operational review of the originator to assess the origination, underwriting and servicing capabilities of the seller. As a result of this review, if Fitch believes that origination, underwriting and servicing procedures are below market standards, an adjustment to the base default probabilities of the whole portfolio is warranted. The relevance of this adjustment is further sized by considering certain elements that cannot be factored into the analysis on a loan-by-loan basis, either because they are not available or because they are only applicable on an aggregate basis.

As mortgage companies, Paragon and MTL specialise in the origination of BTL products through intermediaries, and since February 2001 the vast majority of originations have been to professional BTL investors. To qualify for the benefits of such a loan a borrower must already possess a portfolio of at least three properties and must present a minimum of two years financial accounts for the underwriters to scrutinise. Such professional BTL investors are typically characterised as individuals who earn a substantial portion of their income from the rental yield on their portfolio; indeed, some may rely entirely on this source of income for their livelihood.

For new originations, the rental income from single, self-contained properties must be a minimum of 125% of the mortgage payment calculated on an interest only basis, at either the product rate, or a reference rate of 5%, whichever is the higher. The rental income for all other property types must be a minimum rental income of 130% of the mortgage payment calculated on an interest only basis, at either the product rate, or the reference rate of 7%, whichever is the higher.

Fitch has considered several strengths and concerns in its lender adjustment (see also *Appendix B - Origination, Underwriting and Servicing*).

Among others, the main concerns are as follows: (1) Paragon is a niche market lender and this market has decreased over the last several years. Demand for such products could result in an acceptance of lesser quality loans or applications being agreed or received, however this can be mitigated by the low arrears levels evidenced; (2) only intermediary business is accepted as

Paragon does not have a high street presence, although this is mitigated by the quality and experience of intermediaries on the robustly controlled panel.

In Fitch's view, strengths to consider are as follows: (1) Paragon has an excellent track record with very low levels of arrears and this is assisted by a thorough understanding and application of the receiver of rent policy; (2) affordability is stressed significantly over the current pay rate; (3) all mortgage applications require a full valuation; (4) The MTL loans are part of a Fitch-rated transaction, have high seasoning and have performed robustly since 2001.

It is also important to note that, given the current state of the mortgage market, it is difficult for buyers to secure mortgages due to tighter lending criteria and limited product availability. This has, and quite possibly will for the foreseeable future, cause borrowers to remain in their current rental agreement(s) thus increasing the demand for rental properties and leading to an increase in rents by landlords. This will, and has, caused an increase in revenues for professional landlords and reduced the arrears rates in BTL securitisations. Potential interest rate rises will be the biggest single risk factor.

### Buy-To-Let

Fitch expects 97.9% of the loans in the final pool at the first principal determination date to be prime BTL loans and 2.1% to be prime owner-occupied loans. Fitch considers loans on BTL properties to be inherently more susceptible to default than those secured on an owner-occupied property because:

- the property is not the borrower's prime residence and so the borrower may be more likely to default on the loan during a time of financial stress; and,
- the servicing of the loan is primarily dependent on rental income, which may be more volatile in stress periods than personal income.

In addition, landlord borrowers may target particular regions or groups of tenants within their portfolios, which may lead to a concentration of similar properties in a similar location at the individual borrower level.

One important mitigating feature of BTL loans is that, upon default, the foreclosure process is quicker than for owner occupied properties, as tenants with short-hold tenancy agreements can generally be more easily evicted than owner-occupiers, while the repossession process through the courts is shorter.

In addition, Fitch has noted that a high proportion of the borrowers in this pool are professional landlords, with a minimum of 24 months' experience of managing at least three properties and with a recognised aptitude for enforcing tenancy contracts. The remaining BTL borrowers are private investor landlords, also with significant experience who aim to stay in the market long term.

Professional landlords are believed to be more adept at managing a portfolio of properties, monitoring and acting on economic conditions and market indicators, reducing downtimes between tenancies, and selecting tenant types and target locations than standard borrowers. This assertion is based on the time and energy that professional landlords are able to spend administering their portfolio and researching the market.

For BTL properties a receiver of rent process (ROR) can be used to manage repossessed properties. Following the appointment, the ROR will directly collect rent from paying tenants and pass it to the lender to pay down any arrears. This helps maintain the rental income stream and would thus keep a steady flow of cash to the transaction.

### Interest-Only Loans

Fitch expects 92.0% of the loans in the final pool to be interest only, which is typically the loan-vehicle favoured by BTL borrowers.

Interest-only loans can be construed to be riskier than amortising loans because of the greater risk that the borrower may be unable to repay the debt in full at maturity (ie balloon payment risk). However, interest-only hits will ordinarily not apply to BTL products as the BTL market is almost entirely interest-only which is factored into the general BTL product adjustments. The risk in this transaction is further mitigated by the fact that the borrowers are predominantly professional landlords with a demonstrated ability to manage a property with an interest-only loan, and given the strong historic performance on previous Paragon transactions.

In light of the mitigants above no adjustment has been made to interest-only loans in this pool.

### Concentration Risk

The small initial portfolio size at closing could potentially lead to two levels of concentration risk in this transaction.

The first emanates at the loan level where any single loan could potentially cause disproportionately larger losses than would be the case in a larger more diversified pool. The second relates to Paragon's business model of targeting professional landlords who typically have a number of BTL loans with Paragon. Hence if one landlord has a number of loans in the pool, each one not large in itself, the total exposure could become significant.

Fitch also considers the level of concentration in the transaction's mortgage portfolio to be a key factor in the assessment of tail risk within a particular transaction.

### Receiver of Rent (ROR)

Fitch believes the risk of exposure to a single loan or borrower is mitigated to a large extent by Paragon's reliance on the ROR process. If Paragon believes a borrower is struggling it will appoint a ROR on the entire portfolio of the borrower, which does not require court approval. They will send a surveyor with a property agent to the property and inform the tenant that they have to send their rent to the ROR, who forwards it on to Paragon, instead of paying the landlord and no monies from that point onwards are allowed to be passed on to the borrower. Any payments received in excess of monthly mortgage payments are used to prepay the loans. Where the property is vacant a decision is made to rent or sell the property and a locksmith will also change the locks to the property.

This is a process Paragon initiates early on (typically within two months) as part of a pro-active approach to monitoring and managing arrears. Paragon holds discussions with borrowers, who have been identified as struggling to keep up with payments, regarding their current financial situation and then assess their ability to continue managing the property effectively.

Even if a borrower becomes current at a later date, Paragon is not obliged to release the property back to the borrower, which could effectively force a borrower to redeem all the mortgages with Paragon.

### Self-Employed Borrowers

Fitch expects 49.9% of borrowers in this pool to be self-employed. These are typically professional landlords who rely solely on rental income for their earnings. Given the demonstrated ability of professional landlords to manage a property (based on the previous performance of Paragon transactions) no adjustment was made for borrowers designated as self-employed in this pool.

### Illiquid Properties

Fitch expects 16.9% of the loans to fall into its jumbo and small categories, which represent property values at the less liquid ends of the property market.

Historical portfolio performance in most countries typically shows that high-value and low-value properties tend to realise higher than average relative losses, even in times of low stress in the housing market.

Where a property value is classified as high or low, Fitch will reduce the distressed property value after deduction of the MVD by an incremental illiquidity adjustment factor. These illiquidity adjustment factors are derived by rating scenario, with a larger haircut applied to the distressed property value (i.e. after indexation and MVD) in more stressed scenarios.

## Quick Sale Adjustment

The Market Value Decline (MVD), which reflects Fitch's view of each region's vulnerability to house price declines, and reflects historical experience and socioeconomic factors, also incorporates a QSA. This is the discount a seller is likely to have to suffer for selling a property in a depressed market; often reflecting non-marketable conditions. Professional landlords also tend to modify properties in order to maximise rental yields which can affect the market value of the properties, or use additional revenue to undo the modifications, when it comes to a sale. The QSA is the same across all regions and rating scenarios.

The QSA, calculated using the repossession data provided by Paragon, was about 36% for Paragon and 32% for MTL. As the QSA figures were higher than Fitch's criteria assumption of 22% Fitch has increased the assumptions for the QSA for PM19.

## Geographical Concentration

The mortgage portfolio is skewed towards London and the South East (see Figure 2). Fitch expects about 57.0% of the properties in the mortgage portfolio to be located in London, the South East and Outer Metro.

As that the percentage of loans in London, the South East and Outer Metro is higher than the proportion of the UK population in these regions, the portfolio is more exposed to regional economic declines or natural disasters like flooding. Fitch has therefore increased the default probability of 5.7% of the loans by 15%.

## Default Model Output

The following table illustrates the asset analysis results across different rating scenarios. Fitch has used these WAFF and WARR levels when modelling the transaction cash flows.

The transaction has a pre-funding period in which Paragon will sell further loans to PM19, subject to the conditions including those described above in the *Transaction and Legal Structure* section. Fitch generally expects some limits to be defined in the transaction documentation relating to WA OLTV, CLTV and ICR to mitigate any risk of negative portfolio migration during the pre-funding period. Paragon has included limits on WA ICR, WA CLTV and WA OLTV. WA CLTV will not be greater than 71.25%. The agency has used these weighted-average foreclosure frequency (WAFF) and weighted-average recovery rate (WARR) levels when modelling the transaction cash flows.

Figure 3  
**Fitch Default Model Output (Dynamic Pool – Post Pre-Funding)**

Rating level (%)	WAFF <sup>a</sup>	WARR <sup>b</sup>	MVD <sup>c</sup>
AAA	21.62	47.13	64.53
AA	17.65	52.12	60.84
A	13.68	56.96	57.15
BBB	9.71	61.73	53.46

Recovery time (years): Interest accrued on contractual rate for three years at 'AAA'

Recovery cost: 2.5% plus GBP3,000 fixed cost

<sup>a</sup> Weighted-average foreclosure frequency

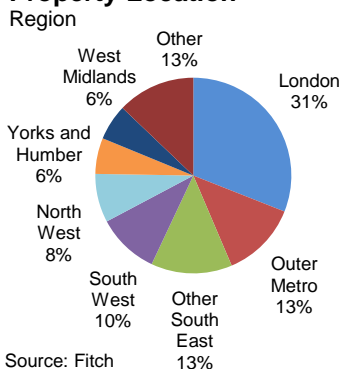
<sup>b</sup> Weighted-average recovery rate

<sup>c</sup> Market value decline

Source: Fitch

Figure 2

## Property Location





## Financial Structure and Cash Flow Modelling

### Credit Enhancement

#### *Subordination*

The class B, C and D notes are sized at 4.50%, 4.00% and 2.00% of the mortgage portfolio respectively, and provide credit enhancement to the class A note. Any principal losses resulting from the mortgage portfolio will be recorded on the PDL which will be paid in such a way that the amount corresponding to the Class A notes will be paid first before the amount corresponding to the class B, C and D notes.

#### *First Loss Fund*

To provide limited coverage for any interest shortfalls and principal losses, the issuer has established at closing, a non-amortising first loss fund to the amount of 3% of the initial total collateral balance. This can step up to 4% of the initial total collateral balance if 60+ days arrears exceed 3% of the outstanding note balance or cumulative losses exceed 2%.

A portion of this first loss fund will be held aside for liquidity. This liquidity amount is sized at 3% of the outstanding rated notes, therefore, only 2% (or 0.06% of the total collateral balance) of the first loss fund is available as credit enhancement at close. The liquidity amount reduces in line with the rated notes, and as such, the excess funds available for credit enhancement are designed to increase as the rated notes amortise. These excess funds are also subject to a PDL trigger which stops them from being used to pay class B or C note interest, once losses have breached a certain threshold.

In addition, the liquidity amount has triggers such that as the PDL increases above 50% for the relevant note class, the liquidity amount is no longer available to pay interest on that class of note. This PDL trigger does not apply to the class A note. As a result, the excess amount of the first loss fund over the liquidity amount – that is available to use as credit enhancement – increases as these triggers are breached. Only this excess amount over the liquidity amount has been taken into account in the calculation of credit enhancement.

The monies held in the reserve fund will not be held in a guaranteed interest contract (GIC) account but will instead be invested in eligible investments, as Paragon believes it will be able to earn a higher rate of return. Fitch has however assumed a sub-Libor rate of return for the purposes of its cash-flow analysis (which is typically the case for a GIC account).

#### *Excess Spread*

Excess spread is also a source of credit support and liquidity for all tranches of notes, with the advantage of being a potentially ongoing resource. However, unlike “hard” cash collateral, excess spread is dependent on the performance of the pool, and as such is often least available when most needed. It is eroded by delinquencies and defaulted loans, which is compounded if higher margin loans are affected. Should high-margin loans amortise more quickly than those with lower margins (whether as a consequence of divergent prepayment rates or shorter tenures), then there is further compression of excess spread.

To the extent available, excess spread, after meeting other senior expenses and interest on the class A note tranche, will be available to replenish any debit balances that arise on the PDLs. In addition, the excess spread can be used to pay down the class A, B and C notes after three years.

### Principal to Pay Interest

If there is a shortfall in revenue funds to pay senior fees and interest on the class A, B and C notes, funds may be reallocated from principal receipts to cover the shortfall. The principal made available to cover these revenue deficits will be recorded on the PDL and is to be recouped from future revenue. Principal funds can only be used in this manner if the relevant class of notes does not have a PDL exceeding 50% of the note balance.

In its cash flow analysis, Fitch has modelled the principal draw mechanism, which is standard among UK RMBS pass-through transactions.

### Minimum Mortgage Rate

The administrator must ensure that the WA margin applicable to the mortgages after taking into account all hedging arrangements, income received from the investment of funds in the transaction account, income from early repayment charges and scheduled releases from the margin reserve fund, is not less than three-month sterling Libor plus 4% until May 2019 and three-month sterling Libor plus 4.5% thereafter. Should the WA margin fall below these levels, the mortgage administrator will be obliged to either:

- increase the rates on variable-rate loans in the pool, to ensure sufficient revenue funds are available; or
- make a drawing on the subordinated loan, such that the required levels are met.

### Margin Reserve Fund

A margin reserve fund, fully funded at closing, has been established to bring the interest payments on the loans to Libor plus 3.00% for the first two years and Libor plus 4.25% thereafter. The fund also acts to mitigate the cost of carry during the pre-funding period. The funds will be released into the revenue waterfall according to a pre-determined schedule.

### Early Amortisation Events: Events of Default

The following will constitute an event of default (EoD):

1. non-payment by the issuer of principal in respect of the notes within seven days following the due date;
2. non-payment by the Issuer of any interest amount on the notes within 15 days following the due date;
3. breach of contractual obligations by the Issuer under the relevant documents which is materially prejudicial to the interests of the holders of the most senior class of notes; or
4. an issuer insolvency event which is materially prejudicial to the interests of the holders of the most senior class of notes.

### Hedging

#### *Interest-Rate Risk*

Payments received by the issuer under the loans are subject to variable and fixed rates of interest.

#### *Fixed Rate-to-Three Month Pound Sterling Libor (Hedged)*

The issuer will enter into a series of interest-rate swaps to address the possible variation between three-month sterling Libor and the rate of interest earned on the fixed loans. The swap is a non-balance-guaranteed swap. This hedging is based on a scheduled step-down balance in line with the fixed-rate mortgages' amortisation schedule. There may be mismatches on the swap due to prepayments or defaults on the fixed-rate mortgages. Fitch has taken this into account in its analysis.

#### *BBR to Three-Month Sterling Libor (Unhedged)*

Bank base rate (BBR)-indexed loans in the PM19 pool will remain unhedged and Fitch has so modelled them. The agency has assumed a conservative 200bp spread from three-month Libor to BBR for the first two years of the transaction, and a spread of 50bp thereafter to account for potential variations in the spread between BBR and three-month Libor.

#### *SVR-to- Three-Month Sterling Libor (Unhedged)*

Standard variable rate (SVR) loans in the PM19 pool will remain unhedged and Fitch has so modelled them. The agency has assumed that the long-term spread of SVR loans to three-

month Libor is 350bp. This is to account for the margin compression that tends to occur in SVR loans as underlying interest rise and lenders cannot fully track those increases.

### Scenario Testing

The capital structure has been stressed in Fitch's rating analysis under certain scenarios, including: high and low CPR scenarios; increasing and decreasing interest-rate scenarios; front and back loaded default curve scenarios.

The stressed scenarios result in no principal losses and the timely payment of interest for each note under each rating category. The most stressful scenarios in the cash flow stress tests are those with a decreasing interest rate, high prepayment, front-loaded default curve.

### Basis Risk

The note coupons are set by reference to three-month sterling Libor on 15 February, May, August and November. Meanwhile, the interest rate for new PML-originated Libor-linked mortgages are set by reference to three-month sterling Libor on 1 January, April, July and October. Also, MTL mortgages are set by reference to either three-month sterling Libor on 1 March, June, September and December, or one-month sterling Libor on the first day of each month. As a result, a 20 basis point haircut has been applied to the margins of these mortgages to account for basis risk.

### Counterparty Risk

Fitch performed an on-site operational review of Paragon in February 2014 to assess, among other things, the lender's origination, underwriting and servicing capabilities (see *Appendix B*).

Review visits do not constitute 'due diligence' and Fitch does not perform due diligence but relies upon the accuracy of data given to it.

### Servicer

Paragon and MTL, as administrators, have delegated their responsibilities to Paragon Finance (PFPLC) which is responsible for administering the mortgage loans in the portfolio.

At the group's West Midlands headquarters, ongoing contact with borrowers is maintained via a telephone-based debt management system known as CACS. CACS enables collection agents to schedule calls to borrowers upon a missed payment and provides a detailed, diary-based collections management platform. Fitch notes that this site has substantial operational history, and considers PFPLC to be more than adequate in its role as servicer. Homeloan Management Ltd (HML) has been designated as substitute administrator.

### Hedge Providers

#### *Interest Rate Swap*

At closing, the issuer will enter into a series of interest rate swaps to eliminate the risk between the fixed rate mortgages and note Libor. This hedging is based on a scheduled step-down balance. The counterparties for the interest-rate swap are Macquarie Bank Limited, rated 'A'/Stable/'F1' and Lloyds Bank plc rated 'A'/Stable/'F1', which satisfy Fitch's expected minimum rating for swap counterparties (detailed in the report entitled *Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum*, published 13 May 2013).

Upon a downgrade of Macquarie Bank Limited or Lloyds Bank plc below Long-Term 'A' or 'F1', one of the following remedial measures must be applied by the swap counterparty:

1. arrangement for a third-party guarantor with the requisite rating;
2. transfer of the swap to a counterparty with the requisite rating;
3. posting of the required collateral to cover the potential loss upon its default; or
4. take such other action as will result in the rating of the notes being maintained or restored.

Only actions (1) and (2) are available upon a downgrade below investment grade. Where collateral is a feasible mitigant — for example, where the swap provider is rated at least investment grade — posting is expected to be effected within 14 calendar days upon the downgrade of the counterparty below 'A' or 'F1'. Where collateral cannot be used as a mitigant, remedial action is expected to be taken within 30 calendar days upon the downgrade of the counterparty.

The swap documents include a clause that allows other unspecified actions, in addition to specific remedial actions, upon the breach of certain thresholds. This clause states that there could be alternative remedies that might be pursued so that a rating downgrade would not occur. Fitch does not consider this clause to have any credit quality effect. The agency will always expect compliance with the provisions of its counterparty criteria upon rating threshold triggers being breached. If remedies as specified in the counterparty criteria are not pursued within specified timeframes, Fitch will analyse the impact of this non-compliance in its rating opinion, and a rating action could follow.

### Commingling Risk

#### *Collections Account and Account Bank*

Mortgage payments are transferred from the servicer's collection account (at Barclays Bank plc, A/ Stable/F1) to the transaction account (also at Barclays Bank plc, A/Stable/F1) within one business day. To mitigate any commingling risk, there is a back-up servicer (HML) in place on day one. Additionally, principal and the first loss fund portion, which is not part of the liquidity ledger, may be used to cover for any class A, B and C note interest shortfalls. If that is not enough, the liquidity ledger sized at 3% of the class A, B and C notes may be used to cover for the class A note interest shortfalls. The liquidity ledger can also be used to cover interest on class B and C notes, subject to the PDL not exceeding 50% of the relevant class balance.

Should the Short-Term IDR of the collection account provider fall below 'F1', or its Long-Term IDR fall below 'A', the collection account must be transferred to an eligible counterparty. This complies with Fitch's criteria on commingling risk (see *Counterparty Criteria for Structured Finance and Covered Bonds*, May 2013, and available at [www.fitchratings.com](http://www.fitchratings.com)).

Under the transaction documents, Paragon, as the transaction administrator, is required to undertake the replacement of counterparties including the issuer account bank, qualified investments, collection account bank and derivative counterparty if the counterparties cease to fulfil criteria defined in the transaction documentation. The criteria defined in transaction documentation relate both to specific minimum ratings (eg 'A'/F1', which are consistent with Fitch's counterparty criteria where the highest rated note is 'AAAsf') and to Fitch's counterparty criteria. This mechanism deviates from Fitch's criteria in that the transaction documents include specific references to Fitch criteria (see *Criteria Updates in Counterparty Criteria for Structured Finance and Covered Bonds*) rather than being self-contained.

The reference to Fitch criteria creates a degree of uncertainty regarding future counterparty arrangements but Fitch does not expect this mechanism to negatively affect note ratings so long as the administrator maintains counterparties that are consistent with Fitch's counterparty criteria. Fitch highlights that as a result of the mechanism the replacement of counterparties by the administrator may be affected by a change to the rating of the highest-rated note or a change in the agency's criteria. For example, if the highest rated note was 'Asf' the administrator may be expected to apply a lower minimum rating of 'BBB+/'F2' to the counterparties. A change in the level of minimum counterparty IDR specified in Fitch criteria may also affect the actions of the administrator.

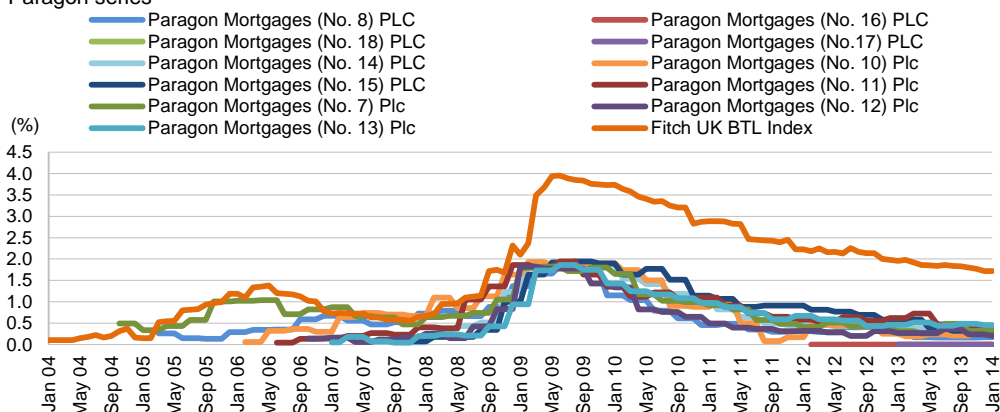
## Performance Analytics

The performance of transactions in the Paragon series remains comparable with one another, with each of the transactions performing well, and better than most other UK BTL transactions. As of January 2014, the percentage of loans in arrears by three months or more ranged between 0% (Paragon 16, 17, and 18) and 0.5% (Paragon 13) of their respective outstanding collateral balances. Paragon's extensive use of receiver of rent policies has contributed towards the relatively low level of arrears seen across the series. Similarly, the 3M+ arrears for the FF4 loans remained relatively low at 0.15% in January 2014.

Figure 4

### 3M+ Arrears

Paragon series

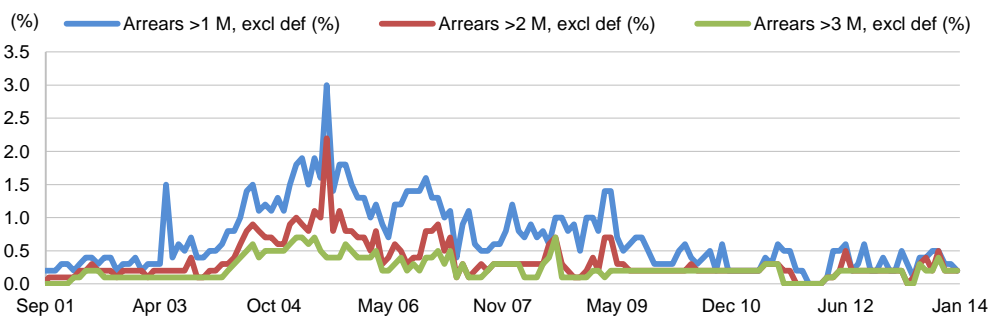


Source: Fitch, investor reports

Figure 5

### Arrears Profile

First flexible 4



Source: Fitch, investor reports

Related Research

Figure 6

**Publication<sup>a</sup>**

<b>General rating and structured finance criteria</b>	
Global Structured Finance Rating Criteria	24 May 2013
<b>Counterparty risk criteria</b>	
Counterparty Criteria for Structured Finance and Covered Bonds	13 May 2013
Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum	13 May 2013
<b>Issuer's currency swap obligations rating criteria</b>	
Criteria for Rating Currency Swap Obligations of an SPV in Structured Finance Transactions	8 August 2012
<b>Interest rate criteria</b>	
Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds	23 January 2014
Fitch's Interest Rate Stress Assumptions for Structured Finance	25 January 2013
<b>Mortgage insurance criteria</b>	
Global Criteria for Lenders' Mortgage Insurance in RMBS	7 September 2012
<b>Country-specific criteria</b>	
EMEA Criteria Addendum - United Kingdom - Mortgage Loss and Cash Flow Assumptions	9 August 2012
EMEA Residential Mortgage Loss Criteria	6 June 2013
<b>Country-specific market studies</b>	
UK Residential Property Value Analysis - A Detailed Review of Sold Properties in Possession	28 February 2013
<b>Surveillance</b>	
EMEA Issuer Report Grades – The Results	11 October 2012
<b>Origination and servicing</b>	
Rating Criteria for Structured Finance Servicers	6 February 2013
Criteria for Servicing Continuity Risk in Structured Finance	10 August 2012

All the above research is available at [www.fitchratings.com](http://www.fitchratings.com)

<sup>a</sup> Criteria can be updated or amended: Readers should always make reference to the latest criteria available at [www.fitchratings.com](http://www.fitchratings.com)

Source: Fitch

Appendix A

Figure 7  
Transaction Comparison

	PM19 <sup>c</sup>	PM18	PM17	PM16
<b>Closing date</b>	<b>March 2014</b>	<b>September 2013</b>	<b>October 2012</b>	<b>November 2011</b>
<b>Total issuance (GBP)</b>	<b>350,000,000</b>	<b>273,000,000</b>	<b>199,568,741</b>	<b>163,800,000</b>
<b>Preliminary credit enhancement %</b>				
AAA	10.56	12.8	15.5	22.6
AA	6.06	7.1	10.25	n.a.
A	2.06	2.1	5.25	n.a.
BBB	n.a.	n.a.	n.a.	n.a.
Initial reserve (% of initial balance)	3.0	3.0	3.0	3.0
Target after arrears/loss triggers	4.0	4.0	4.0	4.0
Liquidity	yes	yes	yes	yes
<b>WAFB (%)</b>				
AAA	21.6	22.6	20.5	20.8
AA	17.7	18.4	16.6	17.0
A	13.7	14.1	12.8	13.2
BBB	9.7	9.9	9.0	9.4
<b>WALS (%)</b>				
AAA	69.8	70.2	68.3	57.7
AA	64.8	64.9	62.7	51.9
A	57.6	57.0	54.6	44.9
BBB	52.8	51.7	48.9	39.2
<b>WARR (%)</b>				
AAA	47.1	47.6	49.6	50.7
AA	52.1	52.9	55.2	56.4
A	57.0	58.3	60.7	62.2
BBB	61.7	63.7	66.4	67.9
<b>WAMVD (%)</b>				
AAA	64.5	61.9	61.2	59.7
AA	60.8	57.9	57.2	55.5
A	57.2	54.0	53.2	51.3
BBB	53.5	50.0	49.2	47.1
<b>Portfolio</b>				
Collateral balance (GBP)	274,929,977	272,981,182	199,568,741	128,928,887
Average current balance per borrower (GBP)	154,567	169,448	227,041	217,052
WA original valuation (GBP) <sup>a</sup>	197,449	204,478	241,685	236,287
Largest indexed valuation (GBP)	2,190,698	3,085,168	2,620,862	2,000,000
WA seasoning (months) <sup>a,d</sup>	31	4	8	19
L/OM/SE concentration (%) <sup>a</sup>	57.0	54.9	47.4	56.6
WA OLTV (%) <sup>a</sup>	70.4	72.9	69.9	69.8
WACLTV (%) <sup>a</sup>	71.8	72.8	69.6	70.0
WACLTV (indexed values) (%) <sup>a</sup>	68.7	72.3	69.5	70.4
WAOLTV>80% (%) <sup>a</sup>	4.9	0.6	0.5	0.2
WAOLTV>90% (%) <sup>a</sup>	0.6	0.0	0.00	0.0
WA ICR (%) <sup>b</sup>	89.6	82.9	88.1	94.3
WA DTI (%)	30.9	n.a.	n.a.	
WA stabilised margin (%)	4.1	4.7	4.7	3.9
Interest-only loans (%)	91.7	93.4	93.5	90.4
Buy-to-let (%)	97.9	100.0	100.0	100.0

<sup>a</sup> As calculated by Fitch

<sup>b</sup> As calculated by Paragon using Fitch's interest rate assumption of 5.5% plus the relevant margin

<sup>c</sup> Final pool characteristics as expected at the end of the prefunding period

<sup>d</sup> WA seasoning; seasoning for Paragon loans is 2 months and for MTL loans is 151 months

Source: Fitch and pool cuts provided by Paragon

## Appendix B: Origination, Underwriting and Servicing

### Origination

Paragon Mortgages Limited (PML) and MTL are subsidiaries of the Paragon Group, which specialises in the provision of various financial products to consumers. As a mortgage company, PML specialises in the origination of BTL products through intermediaries and since February 2001, the vast majority of originations have been to professional borrowers. Since September 2010, a new originator, Paragon Mortgages (2010) Limited has targeted the professional landlord market. To qualify for the benefits of such a loan a borrower must already possess a portfolio of at least three properties and must present a minimum of two years financial accounts for the underwriters to scrutinise.

Such professional borrowers are typically characterised as individuals who earn a substantial portion of their income from the rental yield on their portfolio; indeed, some may rely entirely on this source of income for their livelihood.

For new originations, the rental income from single, self-contained properties must be a minimum of 125% of the mortgage payment calculated on an interest only basis, at either the product rate, or a reference rate of 5%, whichever is the higher. The rental income for all other property types must be a minimum rental income of 130% of the mortgage payment calculated on an interest only basis, at either the product rate, or the reference rate of 7%, whichever is the higher.

PML has five levels of underwriting based on a hierarchy of mandates. To increase borrowings above these levels it may request additional information, such as a business plan or performance data or conduct an interview with the applicant. Large exposures, ie in excess of GBP2m, to single borrowers are monitored via an annual review of accounts, letting conditions, voids, demand, cash flows, as well as a consideration of the borrower's strategy for the next 12 months. These controls are designed to ensure PML is kept abreast of the performance of key borrowers' portfolios, and may mitigate against single obligor concentration within the reference portfolio.

As with other BTL lenders, PML prefers to retain manual discretion in its lending procedures rather than adhere to a pro forma approach. As such, a hierarchy of mandates adhering to guidelines and criteria is in place to ensure that accountability is maintained. At the heart of policy-making is the overarching credit committee - comprising four standing members and other experts, that are called upon as appropriate, - which convenes on a monthly basis and presides over any changes to criteria and special cases.

Professional landlords are believed to be more adept at managing a portfolio of properties, monitoring and acting on economic conditions and market indicators, reducing downtimes between tenancies, and selecting tenant types and target locations than standard borrowers. This assertion is based on the time and energy that professional landlords are able to spend administering their portfolio and researching the market.

MTL was formerly known as First Active Financial Plc. In 2001, when the FF4 was closed, its name was changed to Britannic Money plc (BM). In 2003 it was named MTL. At the time of FF4's closing, BM specialised in the flexible and BTL mortgage markets. Mortgages were originated via direct distribution centres and indirectly through a network of brokers. BM also increasingly used the internet to source originations. The underwriters at BM had experience mostly from other high street lenders. New hires followed a specific training/mentoring programme, after which they were gradually given increasing underwriting limits. Although the underwriters followed the underwriting guidelines established by BM, they were allowed certain "discretion points" based on their seniority/experience. This resulted in an application-to-completion rate of about 60%.



### Underwriting

PML has its own dedicated underwriting team where the underwriters are usually recruited from within the business, and receive one-on-one on-the-job training. If the underwriters are new to the business, it is expected they will need six months training prior to receiving a lending mandate. Monthly sample checks are completed against all underwriters by line management and further random checks are undertaken immediately after completion of a loan. Other control mechanisms are in place on the systems to ensure mandates and lending thresholds are not over-ridden.

HUNTER has been used as a fraud detection tool since 1995 however a successful switch to SIRA (Syndicated Intelligence for Risk Avoidance) occurred during 2006 and is still in place today. Since its re-entry into the buy to let market in 2010, Paragon has introduced a fraud policy to ensure both fraud prevention controls and compliance with regulatory requirements is in place.

### Property Valuation

The Paragon Group has 18 regionally based staff surveyors who complete the majority of valuations; the remainder are completed by "panel" surveyors. It is expected that more unusual properties are surveyed by the staff surveyors. All surveys completed by panel surveyors are audited by a Paragon staff surveyor.

### Servicing

Paragon and Mortgages Trust Services Plc have been appointed to act as the administrators for the Paragon-originated and MTL-originated portions of the pool, respectively. Paragon and MTL will subcontract its duties to Paragon Finance PLC (PFPLC). PFPLC invested in sophisticated collections technology following adverse credit experience suffered by the group in the early 1990s. At the group's West Midlands headquarters, ongoing contact with borrowers is maintained via a telephone-based debt management system known as CACS. CACS enables collection agents to schedule calls to borrowers upon a missed payment and provides a detailed, diary-based collections management platform. Fitch notes that this site has substantial operational history, and considers PFPLC to be more than adequate in its role as servicer.

PFPLC is not a Fitch-rated servicer of residential mortgage loans. For more information on Fitch's servicer rating programme see the reports titled *Global Rating Criteria for Structured Finance Servicers*, dated 30 September 2009 and *Rating Criteria for European Residential and Commercial Mortgage Loan Servicers – UK Market Addendum*, dated 28 January 2008.

### Early Arrears Management

The servicing team currently manages the Paragon and MTL portfolios. Collectors will not see the loan unless it fails a direct debit payment. When that happens for the first time, a telephone call will be made to the borrower within 24 hours to attempt to rectify the situation.

### Serious Arrears Management

If the borrower is two months in arrears, Paragon will appoint a Receiver Of Rent (property agent) on the entire portfolio of the borrower. No court approval is required for this. Paragon will send a surveyor with a property agent to the property and inform the tenant that they have to send their rent to the ROR, who forwards it on to Paragon, instead of paying the landlord. No monies from that point onwards are allowed to be passed on to the borrower. Payments received in excess of monthly mortgage payment are used to prepay the loans. A locksmith will also change the locks to the property where the property is not tenanted and a decision will be made to either rent or sell the property.

Even if the borrower becomes current at a later date, Paragon will not usually release the receiver of rent, which effectively forces a borrower to redeem all the mortgages with Paragon.

### Foreclosure, Repossession and Sale

Once receiver of rent is appointed, the property cannot be sold if a tenancy is in effect unless it is in the best interests of the debt. At the end of the tenancy, Paragon could theoretically extend the tenancy if it chose to, but usually they would obtain vacant possession and sell the property.

### Standby Servicing

Fitch considers the continuous, efficient servicing of the mortgage portfolio as fundamental to the successful performance of a mortgage-backed transaction. As such, it monitors that adequate arrangements are in place to ensure continued servicing in the instance that the named servicer in a transaction is unable to perform its duties. HML is the standby administrator.

## Appendix C: Transaction Overview

### Paragon Mortgages (No.19) PLC

UK/Prime RMBS

Figure 8  
Capital Structure

Class	Rating	Size (%)	Size (GBPm)	CE (%)	Interest rate	PMT freq	Maturity	Margin (%)
A	AAAsf	89.5	TBD	10.56	3-month Libor	Quarterly	Aug 2041	TBD
B	AAsf	4.5	TBD	6.06	3-month Libor	Quarterly	Aug 2041	TBD
C	A+sf	4.0	TBD	2.06	3-month Libor	Quarterly	Aug 2041	TBD
D	NR	2.0	TBD	n.a.	3-month Libor	Quarterly	Aug 2041	TBD

**Reserve fund** 3%  
**Liquidity ledger** 3% of class A, B and C  
**First interest payment date** 15 Aug 2014  
**Issuer call date** 15 May 2017

Source: Transaction documents

### Key Information

<b>Closing date</b>	(March 2014)	<b>Parties</b>	
<b>Country of assets</b>	UK	<b>Sellers/originators</b>	Paragon Mortgages (2010) Limited and Mortgage Trust Limited
<b>Country of SPV</b>	UK	<b>Servicer</b>	Paragon Finance plc
<b>Structure</b>	Sequential	<b>Arrangers</b>	Macquarie Bank Limited and Lloyds Bank plc
<b>Settlement</b>		<b>Joint lead managers</b>	Lloyds Bank plc, Macquarie Bank Limited, Morgan Stanley
<b>Listing</b>	London Stock Exchange	<b>Principal paying agent</b>	Citibank, N.A., London Branch
<b>Analysts</b>	Michael Htun	<b>Collection account/Transaction account</b>	Barclays Bank plc
	Tulika Oommen	<b>Swap counterparties</b>	Macquarie Bank Limited and Lloyds Bank plc

Source: Transaction documents

### Summary

#### Rating drivers

- Buy-to-Let Predominant:** About 97.9% of the portfolio consists of BTL loans. Fitch continues to stress the portfolio's default rates beyond those of a prime owner-occupier portfolio at all rating levels, despite the historically lower arrears of past Paragon deals.
- Pre-Funding Period:** Up to GBP75.0m of additional Paragon-originated loans will be added by the third principal determination date, on 31 July 2014. Any balance remaining to the credit of the pre-funding ledger after this period, not used to purchase additional loans, will be used to pay down the notes sequentially. Fitch has run analysis based on expected pool composition at the third principal determination date, which it expects to be 80.7% Paragon-originated loans and 19.3% MTL loans.
- MTL Loans Performing Well:** The MTL loans were a part of the Fitch-rated FF4 transaction. The loans have performed strongly, with low arrears. The pool is well seasoned, at over 150 months. Fitch considers the good performance favourably and has given this benefit in its analysis.
- Counterparty Rating Trigger Risks:** The rating triggers for the issuer account bank, qualified investments, collection account bank and derivative counterparties in the transaction documents have specific reference to Fitch criteria. This creates a degree of uncertainty regarding future counterparty arrangements.

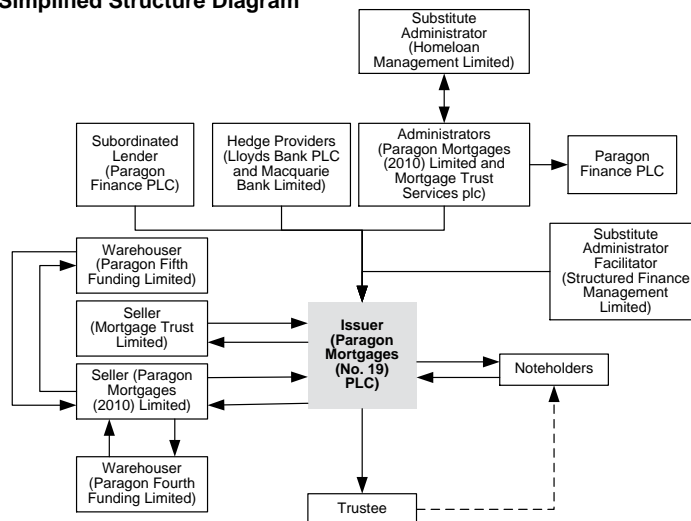
Source: Transaction documents provided by Paragon

### Fitch Default Model Output (Static pool)

Rating level	AAA	AA	A	BBB
WAFF (%)	21.6	17.7	13.7	9.7
WARR (%)	47.1	52.1	57.0	61.7
Loss severity (%)	69.8	64.8	57.6	52.8
MVD	64.5	60.8	57.2	53.5

Source: Transaction documents

### Simplified Structure Diagram



Source: Transaction documents

### Collateral Summary

#### Final pool characteristics (As of 31 Jan 14)

Original principal balance <sup>a</sup>	277,659,434	<b>Regional concentration (%)</b>	
Current principal balance <sup>a</sup>	274,929,977	London, SE & OM	57.0
Average current loan per borrower	155,683	South West	10.2
Number of borrowers <sup>a</sup>	1,912	North West	8.0
Number of loans <sup>a</sup>	2,192	West Midlands	5.9
Seasoning (years) <sup>a,c</sup>	31		
Loan to value (LTV) (%)		<b>Lien position:</b>	
WA OLV	70.4	First ranking	100.0
WA CLTV	71.8	Jumbo (%)	16.9
<b>Mortgage characteristics</b>		<b>Payments</b>	
WA ICR <sup>a,b</sup>	89.6	Payment frequency	Monthly
Buy to Let (%)	97.9	Payment method	Direct debit
		Performing loans (%)	98.9
<b>Interest rate type</b>		<b>Employment status</b>	
Floating rate loans (%)	73.5	Self-employed (%)	49.9
Fixed rate loans (%)	26.5		

<sup>a</sup> Based on provisional pool, and not the expected final pool at the end of the prefunding period

<sup>b</sup> As calculated by Paragon using Fitch's interest rate assumption of 5.5% plus the relevant margin

<sup>c</sup> WA seasoning; seasoning for Paragon loans is 4 months and for MTL loans is 151 months

Source: Pool Data provided by Paragon

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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