Paragon Mortgages No. 4 PLC

Multi Class Mortgage Backed FRNs

UK - MBS

CLOSING DATE

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AUTHOR:

London

David Harrison
Assistant Vice President
(44-20) 7772-5434
David.Harrison@moodys.com

CONTACTS:

London

Jodi van Breda
Analyst
(44-20) 7772-5472
Jodi.vanbreda@Moodys.com

Detlef Scholz
Managing Director
(44-20) 7772-5398
Detlef.Scholz@moodyscom

New York

Vernessa Poole
Asset-Backed Securities and Collateralized Debt Obligations
(212) 553-4796
Vernessa.Poole@moodys.com

WEBSITE:

www.moodys.com

This pre-sale report addresses the structure and characteristics of the proposed transaction based on the information provided to Moody's as of March 2002.

Investors should be aware that certain issues concerning this transaction have yet to be finalised. *Upon conclusive review of all documents and legal information as well as any subsequent changes in information, Moody's will endeavour to assign* ***definitive*** *ratings to this transaction. The definitive ratings may differ from the* ***prospective*** *ratings set forth in this report. Moody's will disseminate the assignment of definitive ratings through its Client Service Desk.*

TRANSACTION IN BRIEF:

	Class A	Class B
Rating:	(P)**Aaa**	(P)**A2**
Amount:	£[457,500,000]	£[42,500,000]
Coupon:	Libor + [26]bps	Libor + [85]bps
Step Up Date:	April 2008	April 2008
Step Up Margin:	Libor + [52]bps	Libor + [170]bps
Final Maturity:	July 2032	July 2044
Interest Payment Dates:	7th day in July, October, January, April	
Issuer:	Paragon Mortgages (No.4) PLC	
Originator:	Paragon Mortgages Limited	
Servicer	Paragon Finance PLC	
Servicer of Last Resort:	Global Homeloans Limited	
Trustee:	Citicorp Trustee Company Limited	
Lead Manager:	ING	
Asset Characteristics:	First residential mortgages to individuals and corporates in England, Wales and Scotland	

***Summary of Provisional Pool* (as at 31 December 2001):**

Count:	5,750 residential loans
Prin. Amt:	£339,573,207.09
LTV:	Avg: 75.51%; 90-95%: 1.29%; 95-100%: 1.10%; 100+%: 0.2%
Loan Size:	Avg: £59,056.21; Max: £601,000.00
Performance:	Current (inc <=1 month arrears) 99.26%
Arrears:	1-3 months 0.49%; 3-6 months 0.15%; 6+ months 0.1%
Loan Usage:	Purchase 55.97%, Remortgage 44.03%
Interest Rate:	Paragon Variable Rate 31.36%; Capped 0.04%; LIBOR-linked 35.49%; Fixed Rate 33.11%
Concentration:	North 3.76%; N.West 9.95%; Yorks 10.26%; E.Midlands 4.40%; W.Midlands 6.11%; E.Anglia 4.64%; S.East 29.75%; S.West 8.54%; G.London 17.87%; Wales 3.62%; Scot 1.12%
Seasoning:	1994 0.10%, 1995 3.28%, 1996 7.02%, 1997 19.71%, 1998 0.04%, 2000 0.01%, 2001 69.83%
Mtg Indem. Ins:	Heath Lambert Insurance Service Ltd (7.58% of the portfolio is covered by MIG insurance)
Credit Support:	First Loss Fund (1.75% of the principal amount outstanding of the notes at closing), the Class B Notes and Excess Spread.
Launch Date:	[22 March] 2002

RATING OPINION

Moody's has assigned prospective long term credit ratings of **(P)Aaa** to the Class A Notes and **(P)A2** to the Class B Notes of the Issuer.

Moody's issues prospective ratings in advance of the final sale of securities, and these ratings only represent Moody's preliminary opinion. Upon a conclusive review of the transaction and associated documentation, Moody's will endeavour to assign definitive rating to the Notes. A final rating may differ from a prospective rating.

The rating of the Class A Notes is based upon an analysis of the characteristics of the mortgage pool backing the Notes, the protection the Notes receive from credit enhancement against defaults and arrears in the mortgage pool, and the legal and structural integrity of the issue.

The ratings of the Class B Notes are based on the above factors, and on an assessment of the extent of their subordinate position within the structure.

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

Collateral

The most distinctive feature of recent transactions from Paragon has been the high proportion of mortgage loans secured on let, as opposed to owner occupied, properties. These amount to 84.3% of the balance of the loans in the provisional pool. Although Moody's believes that the performance of these types of products may exhibit more volatility over the economic cycle, we are comfortable with the transaction for the following reasons;

1. The strong underwriting and origination procedures used by Paragon Mortgages Limited ("PML"),
2. The strong performance of prior loans secured on let property previously originated by PML. The arrears and losses observed in recent Paragon securitisations have been much lower than in most prime mortgage backed transactions from major mortgage originators.
3. The moderate LTV levels in the pool.
4. The presence of loans originated by Paragon between 1994 and 1998, which had previously been securitised in the "Homeloans" deals. These loans have substantial amounts of seasoning and very low arrears. It is the presence of these loans which Moody's believes increases the average credit quality of the pool, and hence the enhancement in this deal is materially lower than in preceding deals issued under the 'Paragon Mortgages' label.
5. The level of credit enhancement available in the deal.

The average LTV of 75.51% is slightly lower than the previous Paragon transaction and compared to the enhancement in the previous transaction, the first loss fund has reduced from 2.0% to 1.75%. However, the transaction benefits from any excess spread in the deal. Paragon have pledged to maintain the gross margin in the deal at a minimum level of 1.60% until the Note step up date, and 2.00% thereafter, or to inject additional funds into the transaction

Credit Enhancement

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

Excess Spread and the MMR

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

1. the income receivable by the Issuer under the mortgage loans and its other investments and swap arrangements; and
2. the amounts of interest due by the Issuer on account of its various ongoing costs and expenses and under the Notes and swap arrangements.

Excess Spread is to be applied by the Issuer first in reduction of any principal deficiencies that have arisen following a principal loss on any of the loans, and then in increasing the First Loss Fund to the required amount. (Such losses are recorded on the Principal Deficiency Ledger, which is a ledger maintained for this specific purpose.)

The transaction benefits from a Minimum Mortgage Rate ("MMR") which provides some guarantee as to the amount of Excess Spread that will be available; under the MMR, the Administrator must set the rate on the variable rate mortgages in the portfolio so as to ensure that the weighted average interest of the portfolio taken as a whole plus any other income received by the Issuer is at least 1.60% in excess of the Libor rate applicable to the Notes, although there is an option for the Issuer to borrow further amounts under the subordinated loan made by PFPLC so as to cover any shortfall that exists.

However, the credit enhancement value of the MMR, and the Excess Spread that it generates, depends on a number of factors such as relative prepayment speeds of the various loan types in the portfolio; should the variable rate loans (including the Libor-linked loans), which make up 67% of the provisional pool, prepay more quickly, then the portfolio would be dependent on an increasingly small number of variable loans generating sufficient revenue to cover any shortfall arising with respect to other loan-types (such as fixed and capped rate loans) in the portfolio. Moody's has analysed the likelihood of adverse prepayment speeds and is satisfied that the residual risk is consistent with the rating levels, especially given that the majority of fixed and capped rate mortgage loans revert to a variable rate after a fixed initial period of up to 3 years.

The credit enhancement value of Excess Spread also depends on the timing of principal losses. Excess Spread is available on a "use it or lose it" basis and so, if not used or to reduce the Principal Deficiencies Ledger, to top up the First Loss Fund, it is paid back to PFPLC via the Subordinated Loan and other profit extraction mechanisms; which might occur before losses on the portfolio have shown through. The value of the Excess Spread was assessed by Moody's under a variety of adverse conditions.

First Loss Fund

The second layer of protection for investors in the Notes is the First Loss Fund (equal to 1.75% of the principal balance of the notes at closing (see below)). This fund is available to pay interest and senior cost obligations of the Issuer and to make up any principal losses on the PDL should there be insufficient spread on the assets to meet these obligations. The required balance of the First Loss Fund may amortise after May 2006 in line with the mortgage collateral so that it equals 3.5% of the current principal balance of the outstanding mortgage pool, but only if (a) there is no debit balance on the PDL, and (b) less than 6% of the pool by principal balance is more than 3 months' in arrears. Moody's believes that these are very strict tests to meet.

Principal Subordination

The third layer of protection for investors is the subordination of the principal balance of the B Notes to the A Notes. The Class A Notes redeem sequentially but begin to redeem pro rata with the Class B Notes after 5 years but only if:

1. the ratio of Class B Notes to Class B Notes and Class A Notes is at least twice the ratio calculated as at closing;
2 there is no debit balance on the PDL;
3 less than [7.5]% of the pool by principal balance is 3 or more months in arrears; and
4 pro rata redemption would not cause the principal balance of the Class B Notes to fall below £[23.5]m.

Interest/Interest Subordination

Further protection is provided via the subordination of interest due under the Notes; on each interest payment date, all income (after paying certain senior costs and expenses) is allocated first to pay Class A interest and then Class B interest.

Interest/Principal Subordination
In addition, in certain circumstances, Class B Note interest is subordinated to payment of principal under the Class A Notes. This occurs where outstanding principal losses exceed the then Class B Note balance; in this circumstance, payment of Class B interest is subordinated to the topping-up of the reduction of the PDL and to the First Loss Fund. Class B interest is therefore effectively subordinate to A Note interest and principal but not Class B principal.

Liquidity

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

Principal Paying Interest
The Issuer has the ability to use principal receipts under the mortgage loans to meet its senior expenses obligations and interest due under the Class A Notes (but not the Class B Notes). This provides substantial protection for investors in the Class A Notes against a gradual deterioration in the arrears performance of the portfolio. Moody's believes, however, that the fact that the Issuer is unable to use principal receipts to pay the Class B Notes exposes the Class B Notes to greater liquidity risk than is common in UK MBS.

First Loss Fund
As described above, the First Loss Fund is available to cover interest shortfalls under the Notes. The value of the liquidity support provided by the First Loss Fund is reduced by the fact that the First Loss Fund is topped-up after payments have been made to investors in respect of any PDL balances that may arise within the structure. This represents a change from the three preceding 'Paragon Mortgages' transactions, and in Moody's opinion could materially reduce the liquidity available to investors in the junior Notes. Moody's notes that the actual size of the First Loss Fund is somewhat larger than the amount it requires to support the A2 rating on the Class B Notes. Thus, this liquidity concern is mitigated by the availability of these additional funds. The availability of the First Loss Fund to pay Class B Note interest is, however, limited in the manner described in "*Interest/Principal Subordination*" above.

Liquidity Facility
The Issuer does not have the benefit of a separate liquidity facility. Moody's believes that the First Loss Fund, which is topped-up from Excess Spread, provides adequate liquidity support for the transaction.

Interest Rate Risk

The mortgage loans either charge interest at a variable rate set by PML (31.36% of the provisional pool), or by reference to 3 month Libor (35.49% of the provisional pool) or at a (temporarily) fixed or capped rate (33.15% of the provisional pool), whereas payments under the Notes are to be calculated by reference to 3-m sterling Libor. The MMR mechanism described above partially mitigates this risk because it ensures that weighted average rate received by the deal exceeds Libor under the Notes plus the relevant margins. However, as mentioned above, the protection afforded by this mechanism is susceptible to a number of factors such as relative prepayment speeds of the various loan types in the portfolio.

In order to further mitigate interest rate, the structure also benefits from interest rate swaps and caps provided by JPMorgan Chase Bank, London Branch (**Aa2**, **Prime-1**) in respect of the fixed and capped rate mortgages. The swap may require the Issuer to pay certain break costs to the swap provider in the event that mortgages default or prepay, but payments of these amounts is deeply subordinated.

The Issuer is also obliged to enter into suitable arrangements with respect to the hedging of further fixed rate or capped rate loans acquired subsequently via the Pre-Funding mechanism or as a result of conversion (see below).

Conversion

The Servicer may alter the payment method between repayment and interest only and may also convert fixed rate into floating rate mortgages and vice versa. However, there are pre-conditions to any conversion between interest charging methods; for example, if required to maintain the ratings on the Notes, appropriate hedging must be in place.

Further Advances

The Issuer may use principal receipts from the mortgage portfolio to make further advances to the mortgage borrowers, but the cumulative amount of further advances is subject to a cap of £70m, and is also conditional on the Issuer's continued compliance with various contractual restrictions contained in the transaction documents. In addition, if Moody's indicates to the Issuer that the making of additional Further Advances will result in a downgrade of the Notes, then, unless the First Loss Fund is increased to a level such that Moody's confirms the ratings of the Notes will not be downgraded if additional Further Advances were to be made, the Issuer will no longer be entitled to make Further Advances.

Pre-Funding

Part of the proceeds of the Notes will be retained by the Issuer and will be used to purchase a further tranche of mortgage loans, on or prior to the first Principal Determination Date. However, before further loans can be included within the transaction in this way, Moody's must confirm its ratings of the Notes. Any amounts that are retained for Pre Funding will, to the extent not applied in the purchase of further loans, be applied in redemption of the Notes on the first Interest Payment Date.

Servicing

Paragon Mortgages Limited, the seller and originator of the loans, is a wholly owned subsidiary of Paragon Finance PLC, the transaction's mortgage administrator. Moody's believes that Paragon has a well developed servicing business with a track record of successful collections and arrears management in the United Kingdom. In addition, Global Home Loans Limited, is the servicer of last resort.

Accrued Interest

The Issuer will purchase all loans which are "current" as at purchase date at par and the amount of all interest and arrears as at purchase date will be retained by PML. Loans which are not current will, however, be sold at par plus the amount of all interest and arrears as at the purchase date. The transaction structure provides for this to be repaid as follows: each payment received will be treated as first representing accrued interest and arrears, current interest and finally principal. It is a term of the transaction that, should the rate at which such interest and arrears amounts are collected fall below Moody's expectations, Moody's may specify that the First Loss Fund is to be increased to a higher amount in order to mitigate this risk.

Structure

Purchase of mortgage loans

The Issuer used the Note proceeds:

1. to purchase a portfolio of UK residential mortgage loans originated by Paragon Mortgages Limited ("PML");
2. in funding the initial balance of the Pre-Funding Reserve, which is a reserve fund to be used to purchase further mortgage loans up to and on the first Principal Determination Date.

The Issuer utilised the proceeds of a subordinated loan from Paragon Finance PLC ("PFPLC") to fund the £[8.75]M First Loss Fund.

Ownership of Issuer
The Issuer is a special purpose vehicle incorporated in England ultimately owned by The Paragon Group of Companies PLC. Typically, UK MBS transactions rated by Moody's have featured an orphan SPV as issuer. The fact that the Issuer is not an orphan company introduces additional risks not typically found in UK MBS transactions:

- as a matter of UK tax law, it is possible that a subsidiary can be fixed with liabilities for tax of another member of its group. In this case, Moody's expects that an extensive range of undertakings will provide assurance that the chance of such secondary liabilities arising is remote.
- a company organised in the UK can be wound up by a shareholders' resolution. Whilst, in the circumstances, there might be little advantage to be gained by a liquidator of the Issuer's parent company by doing this, Moody's stress scenarios envisage such an attempt being made. Moody's is, however, satisfied that the combination of the non-petition covenants given by the parent companies in the Paragon group, and the share ownership structure of the Issuer, effectively eliminate this risk. The legal opinions confirm this point.

VAT Grouping
In common with other Paragon transactions rated by Moody's (see the previous "Paragon Mortgages" and "Finance For People" deals), but unlike the vast majority of UK MBS transactions, the Issuer is grouped with the rest of the Paragon Group for VAT purposes. The VAT grouping means that services or goods provided between members of the VAT group are not subject to VAT (which would otherwise be payable on servicing fees); but, as a consequence, each member of the VAT group is jointly and severally liable for VAT liabilities of all other members of that group. A long standing arrangement is in place to mitigate this risk:

1. A Trust Account, held in the name of Citicorp Trustee Company Limited as trustee with National Westminster Bank Plc (**Aa1**, **Prime-1**), can be used by any member of the VAT group to meet group VAT liabilities should PFPLC (which, as representative member, is primarily liable for group VAT) fail to do so. PFPLC must maintain a minimum balance in the Trust Account equal to the greater of (1) £120,000, (2) 1.2 times the actual VAT liability for the Paragon VAT Group in the last two accounting periods, or (3) 1.2 times the sum of the estimated VAT liabilities of the Paragon VAT Group for the current and next succeeding accounting periods.
2. If PFPLC fails to pay VAT due by it, or fails to maintain the minimum balance in the Trust Account), the Issuer will automatically be de-grouped; on a degrouping, no new VAT liabilities will arise but any that exist remain. The VAT authority cannot prevent a company from de-grouping, but it must be given 90 days' prior notice.

Collections and Bank Accounts
The overwhelming majority of payments under the Loans are collected by PML under the direct debit scheme. All receipts in respect of the loans will be paid directly into the PML collection account, and will be held on trust for the Issuer pending transfer into the transaction account of the Issuer as appropriate. These transaction accounts are dedicated accounts of the Issuer held with National Westminster Bank Plc (**Aa1**, **Prime-1**). Cash in the transaction accounts must be invested by Paragon Finance Plc as administrator in eligible investments which meet certain criteria, including a requirement that the investments are rated either **Aaa** or **Prime-1** and mature prior to the next interest payment date.

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