RMBS/UK
Presale Report

Paragon Mortgages (No. 7) PLC

Expected Ratings*

Class	Amount (m)	Final Maturity	Rating	CE (%)
A GBP Equivalent 720m				
A1a	USD [ ]	2034	AAA	12.2
A1b	GBP[ ]	2034	AAA	12.2
A1c	EUR [ ]	2034	AAA	12.2
B GBP Equivalent 80m				
B1a	USD [ ]	2043	A	2.2
B1b	GBP [ ]	2043	A	2.2
B1c	EUR [ ]	2043	A	2.2

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* Expected ratings do not reflect final ratings and are based on provisional pool information provided by the issuer as of 6 May 2004.

■ Summary

This GBP800 million equivalent transaction is a securitisation of residential mortgages originated in the UK. Fitch Ratings ("Fitch") has assigned expected ratings to the notes to be issued by Paragon Mortgages (No. 7) PLC (the "issuer" or "PM7") as indicated at left.

The expected ratings are based on the quality of the collateral, available credit enhancement, the underwriting processes of Paragon Mortgages Limited ("PML") and Mortgage Trust Limited ("MTL"), as well as the servicing capabilities of Paragon Finance PLC ("PFPLC") in relation to the PML mortgages and Mortgage Trust Services plc ("MTS") in relation to the MTL mortgages. All four entities are wholly owned subsidiaries of The Paragon Group of Companies ("the Group"). The expected ratings are also based on the capabilities of GHL Mortgage Services Limited ("GHLMSL") as stand-by administrator and the sound legal structure of the transaction. Credit enhancement for the class A notes will be provided by the subordination of the class B notes (10%) and a reserve fund of 2.2%, which will be fully funded at closing. The reserve fund will build up to 2.9% on the occurrence of certain arrears triggers.

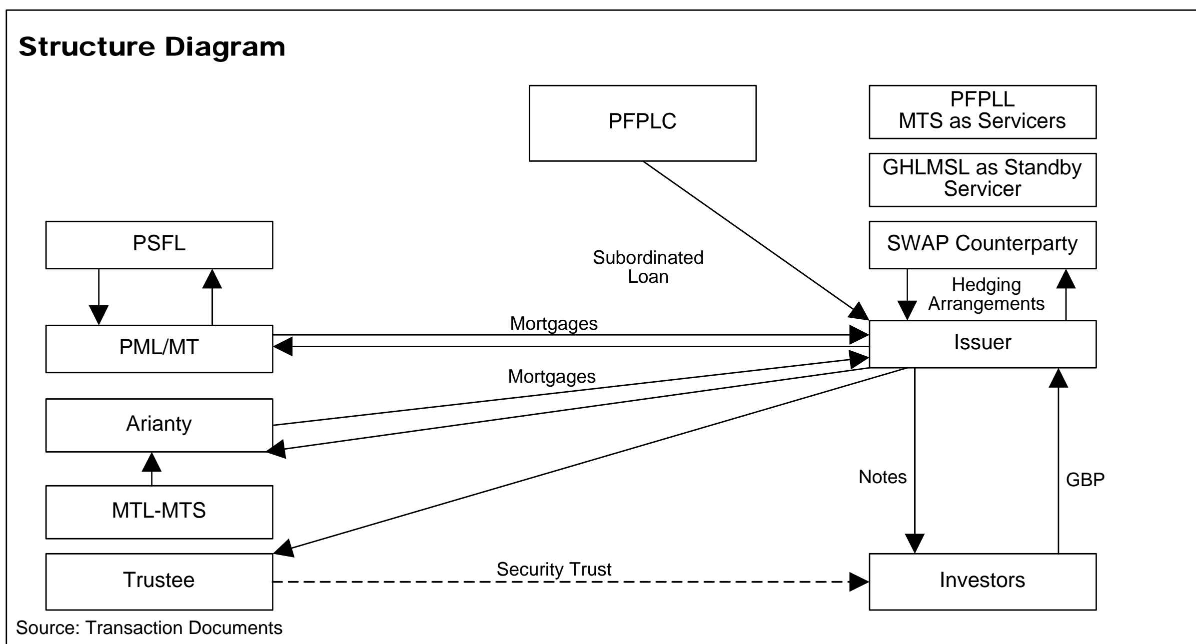
Approximately 62.6% of the loans to be sold into the trust were originated by PML, while 4.6% are mortgages originated by MTL. Some 18.88% of the mortgage trust will consist of loans originally part of the trust property for Paragon No. 1 ("PM1") and originated by PML, while 13.93% will comprise loans originally part of Finance for People No. 4 ("FFP4"), also originated by PML. Both PM1 and FFP4 were called in April 2004.

In the context of residential lending, PML specialises in the origination of buy-to-let loans to "professional" landlords, defined as borrowers with at least 12 months' experience managing at least three rental properties. MTL specialises in lending to "emerging professional" landlords with between one and five properties in their portfolio. Some 97.21% of the loans in the reference portfolio are secured on investment properties belonging to such borrowers and the remaining 2.77% are on owner-occupied properties.

The Group offers an array of financial products, ranging from personal, retail point of sale and auto loans to prime residential mortgages. This is the Group's seventh transaction in the Paragon Mortgages series.

To determine appropriate credit enhancement levels, Fitch analysed the collateral using its UK Residential Mortgage Default model as a benchmark and adjusted it to account for additional risks associated with buy-to-let lending (see research *"UK Residential Mortgage Default Model II"* of 13 October 2000, available on *www.fitchratings.com)*. Fitch also modelled the cash flow contribution from excess spread using its European RMBS cash flow model (see research "*European RMBS Cash Flow Criteria*" of 20 December 2002 available on www.fitchratings.com) using the default and recovery assumptions indicated by the default model. The cash flow test showed that each class of rated notes could withstand loan losses at a level corresponding to the related stress scenario without incurring any ultimate principal loss or interest shortfalls on interest payment dates.

7 May 2004



Special Reports

The following special reports provide additional detail on the Fitch rating approach to, and performance of, the RMBS market and both are available on www.fitchratings.com:

- *"UK Residential Mortgage Default Model II"*
- *"A Guide to European RMBS Cash Flow Analysis"*

■ Credit Committee Highlights

- The portfolio consists of loans originated by PML, totalling 62.6% of the trust by value, and by MTL (4.6%). Some 18.88% of the mortgage trust will correspond to loans that originally formed part of the trust property for PM1 and 13.93% to loans that were originally part of FFP4; in both cases, the loans were originated by PML.

- Some 97.21% of the portfolio consists of buy-to-let loans. Fitch believes that, *ceteris paribus*, an investment property borrower will be more likely to default on a mortgage obligation in a downturn than a borrower whose loan is secured on his or her home. However, in mitigation, most of the PML borrowers (81.47% of the portfolio) are considered professional landlords, with a proven history of maintaining a portfolio of investment properties. The remaining 18.53% MTL mortgages are viewed as emerging professional landlords making a long-term investment in the property market.

- There is a degree of "granularity" in the pool owing to clusters of properties in certain districts favoured by professional and emerging professional landlords.

- It is possible that a single professional borrower could accumulate upwards of 20 mortgage loans from PML, each backed by a property and a corresponding stream of rental income, while in MTL the emerging professional borrower usually has between two and five properties. Whilst this represents an increased exposure to a single obligor, the normal evolution of an investment portfolio over time means that all its constituent loans are unlikely to find themselves in a single securitisation issue.

- Arrears levels for PML'S mortgage portfolio are currently well below those of prime portfolios and of the rest of the buy-to-let sector (based on Council of Mortgage Lenders arrears data). The called transactions (PM1 and FFP4) originated by PML have also demonstrated low arrears levels despite seasoning of five years. Fitch has therefore given more credit to PML'S ability in terms of loan underwriting and the quality of PFPLC'S arrears management. MTL arrears have been slightly higher due to the borrower characteristics in its target market.

- Fitch continues to stress the portfolio's default rates beyond those for a prime owner-occupier portfolio at all ratings levels, despite the current low level of arrears. This stress addresses the relative youth of, and lack of historical track record in, the UK buy-to-let sector in general, as well as addressing some concern surrounding

Key Information

Structure

Issuer: Paragon Mortgages No 7 PLC ("PM7").

Lead Manager: Royal Bank of Scotland ('AA+/F1+')and Barclays Capital

Originator: Paragon Mortgages Limited ("PML") and Mortgage Trust Limited ("MTL")

Trustee: Citicorp Trustee Company Limited.

Paying Agent: Citibank N.A. ('AA+/F1+)

Mortgage Administrator: Paragon Finance PLC and Mortgage Trust Services plc

Special Servicer: Paragon Finance PLC and Mortgage Trust Services plc

Standby Mortgage Administrator: GHL Mortgage Services Limited ("GHLMSL").

Cash/Bond Administrator: Paragon Finance PLC

Basis Hedge Provider: JP Morgan Chase Bank ('A+/F1')

Currency Swap Provider: The Royal Bank of Scotland plc

Account Bank: National Westminster Bank ('AA+/ F1+') for PML and Barclays Bank PLC ('AA+/ F1+') for MTL

Interest Payments: Quarterly in arrears for Class A and B notes, starting on [15 November 2004] and thereafter on the 15th day of February, May, August and November in each year.

Legal Maturity: For the A notes, May 2034; for the B notes, May 2043

Optional Redemption: In May 2008 or step-up date in May 2010, or any payment date thereafter, or clean-up call when 20% or less of the original principal balance is outstanding

Provisional Pool Characteristics

Figures are inclusive of maximum drawable balances and will consequently differ marginally from those in the Offering Circular

Total Amount: approx GBP 557.5 million (7,261 loans)

WA Current LTV: 70.54%

WA Current Interest Rate: 5.86%

WA Remaining Maturity: 238.6 months

WA Seasoning: 23.09 months

Interest-Only Mortgages: 79.82%

potential oversupply of buy-to-let property, particularly in London and the South East.

- The portfolio consists of 4.60% flexible loans all of which are originated by MTL. The flexible mortgage product affords borrowers the ability to prepay a portion of their principal balance at any point (monthly, annually, etc) and use the prepaid amount as a line of credit that they can redraw at any point in the future. Some borrowers with interest-only loans may draw on a line of credit limit greater than their original drawdown. In addition, borrowers may take "payment holidays" applying prepaid amounts in lieu of scheduled payments. The general limitations, however, include that if the borrower prepays more than 20% (the "threshold amount") of the scheduled principal balance, a "commitment fee" of 1% per annum will be charged on amounts in excess of the threshold. The borrower may reschedule their loan to avoid such penalties, but the redraw would then not be available. In most cases, and for all newly originated loans, MTL retains the right to change the commitment fee at any time.

- Borrowers of flexible mortgages are entitled to take advantage of their flexible features, including redrawing and payment holidays, which are available to borrowers to the extent that they have prepaid. Fitch believes that if borrowers experience financial distress, some may redraw and postpone payments prior to eventual default, and has adjusted its loss severity assumptions accordingly.

- The maximum aggregate principal amount of arrears mortgages which may be purchased as at the date of purchase is GBP8 million. This is mitigated though the increased default probability applied to mortgages in arrears.

- Interest rates have been stressed to LIBOR plus 1.5% on an interest-only basis for calculating the debt service coverage on the provisional.

- Less liquid properties comprise 25.5% of the portfolio. This risk is mitigated, as most of these properties are large dwellings broken down into individual apartments.

- There are no A1 money market notes in the transaction.

- As at closing, 12.5% of the principal raised through the note issuance will be retained in the transaction account and applied on the first payment date towards the purchase of further loans (pre-funding). This retention of funds will result in a lower return than if the funds were invested in higher-yielding mortgages, therefore creating negative carry for the transaction during

the first interest period. The first interest payment date is in November 2004.

Credit Structure

The financial structure of the transaction is designed to provide differing degrees of credit enhancement to the note tranches. The class A notes are protected firstly by any excess spread, secondly, by the reserve fund (2.2%) and thirdly by the subordination of the junior tranche (10%). The class B tranche is supported firstly by any excess spread and secondly by the reserve fund.

The reserve fund will also be available to cover interest shortfalls and losses, subject to certain restrictions on paying interest on the junior notes (see "Reserve Fund" below). The reserve fund will increase further to 2.9% in the event that a certain level of arrears is exceeded.

Available residual excess spread is used to replenish the reserve fund (if drawn) to its required amount on every payment date before the remainder returns to the originator.

Revenue Priority of Payments

Payments received by PM7 are split into revenue and principal and are, subject to certain exceptions (see "*Principal Used for Senior Interest Liquidity*"), paid via separate waterfalls. All revenue received on the issue (eg borrower interest payments, swap payments and interest earned on cash in the collections accounts prior to the interest payment date) will be applied on each payment date in the following priority of payments;

1. Trustee and substitute servicing fees.
2. Senior Servicer fees.
3. *Pro rata*, amounts due and payable: (i) under the basis and class A1a and A1c currency swap agreements; and (ii) as interest to the class A noteholders.
4. *Pro rata*, amounts due and payable: (i) under the class B1a and B1c currency swap agreements; and (ii) as interest to the class B noteholders.
5. VAT to be paid, if any.
6. Amounts applied in extinguishing a debit balance on the PDL.
7. Amounts required to replenish the reserve fund.
8. Other subordinated amounts, including a provision for a reserve to fund any purchase of caps, other hedging instruments in the next period, the subordinated Servicer fee and deferred purchase consideration.

Should the debit balance recorded on the PDL exceed the balance of then-outstanding class B notes, items (4) and (5) will be relegated below item (7). This ensures that any PDL debit balance corresponding to the class A notes will be reduced to zero prior to the payment of interest on class B notes.

Principal Used for Senior Interest Liquidity

Principal receipts may be used to pay interest on the class A notes in the event that it cannot be paid from excess spread and amounts in the reserve fund. The PDL will be debited by the amount used to pay senior interest. This debit balance will then be repaid at the relevant position in the revenue priority of payments using available revenue.

Principal Redemption

Mandatory

All amounts recorded as principal (including scheduled repayments, prepayments, amounts credited to the PDL and defaulted loan sale proceeds) other than in respect of senior interest shortfalls not covered by revenue funds, or further advances extended during the previous period, will initially be passed through to noteholders sequentially. However, this will only occur provided that:

- the balance of junior notes as a proportion of the total outstanding balance of notes exceeds two times that at closing;
- it is after [May 2009];
- there is no debit balance on the PDL;
- the balance of loans in arrears for over three months is less than 7.5% of the then-current balance;
- the outstanding balance of class B notes is greater than 4.76% of the original principal balance; and
- amortisation will be *pro rata* to maintain the ratio of B notes to senior notes at that time.

Optional

At the option of the issuer it is possible to redeem all of the class A and B notes at their respective outstanding principal amounts plus accrued interest in the following circumstances:

- on or after the interest payment date in May 2008;
- if the then-current outstanding principal amount is less than 20% of the original principal balance;
- if the issuer is required to make any withholding tax deductions.

Fitch's ratings do not address the possible exercising of these call options held by the issuer.

Final
To the extent not previously paid down, class A notes are due to be redeemed in full in May 2034 and B notes in May 2043.

Interest Rate and Basis Risk
At closing, [10.96] % of loans will have a fixed rate of interest for a specified period lasting until, at the latest, December 2009. While only a few of these will remain fixed-rate loans after July 2008, the possibility of variable rate loans subsequently being converted into fixed-rate loans may account for a higher number of fixed-rate loans existing in the portfolio after this date.

In order to hedge its exposure to fixed- and capped-rate loans in a rising LIBOR (London Interbank Offered Rate) environment, the issuer will enter into a master interest rate exchange agreement with JP Morgan. Any increase in this exposure will be accompanied by a suitable extension of the hedging arrangements, funded from excess spread trapped in a subordinated position in the revenue priority of payments on the previous payment date.

Some 20.02% of the portfolio is charged against PML's or MTL's standard variable rate ("SVR"), which itself can be based on three-month LIBOR or Bank of England Base Rate. To the extent that the mortgage interest rates have different reset dates to those of the notes, incremental additional costs may be incurred by the issuer which, in the first instance, will reduce excess spread income.

In addition to the hedging arrangements, PML has a threshold interest margin mechanism in this transaction designed to ensure that the weighted average contractual margin over three-month LIBOR on the reference portfolio as a whole will be at least 1.6%, rising to 2% after May 2010. Should the weighted average margin fall below these levels, the mortgage Administrator will, under the mechanism, be obliged to increase the SVR on the pool or ensure that there are sufficient funds in the shortfall fund to maintain the minimum level. Fitch has stressed the threshold interest margin rate that is achieved in its AAA analysis.

Currency Risk
The issuer will enter into currency swaps to hedge the currency mismatches between the GBP-denominated assets and the USD and EUR note liabilities of some of the note classes. The currency counterparty must be rated at least 'F1' by Fitch. In the event of a downgrade of any counterparty below this level, the counterparty will be required to collateralise any exposure, obtain a guarantee from a suitably rated counterparty or find a suitably rated replacement provider.

Pre-funding
The issuer has the right to purchase further mortgages up to 15 November 2004 (the first payment date), using funds set aside at closing from the proceeds of the notes and credited to the pre-funding ledger. Fitch must confirm that any pre-funded loans will not adversely affect the rating of the notes before they are included within the reference portfolio. At the first interest payment date, any balance which remains to the credit of the pre-funding ledger, which was not used to purchase mortgages, will be used to pay down the notes. Negative carry resulting from holding the funds in the GIC account is mitigated by the guaranteed minimum margin on the portfolio for the 'A' rated note. The negative carry was incorporated into the cash flow modelling for the 'AAA' stresses.

Non-Verified Loans
As at the date of this report, all the loans by current balance had made their first payment. At closing, non-verified loans will not be purchased into the portfolio. To the extent that such non-verified loans receive their first monthly payment prior to the first payment date, pre-funding amounts will be applied to purchase these loans at that date.

Credit Enhancement and Liquidity

Reserve Fund
The reserve fund of GBP17.6 million (2.2% of the issue) will be fully funded at Day 1 via a subordinated loan advanced by Paragon Finance PLC. The reserve fund will further increase to 2.9% in the event that arrears in excess of 60 days exceed 3% of the portfolio.

Any drawings of the reserve fund (to cover losses or revenue shortfalls) will be replenished using available excess spread. The fund has been sized by Fitch to ensure that the notes have sufficient credit protection and liquidity support to merit their respective ratings.

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, an effect that 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. Furthermore, high prepayment rates on the portfolio as a whole would squeeze the gross amount of credit enhancement available over the course of the transaction. To take account of these factors in its cash flow modelling, Fitch applied its performance assumptions (derived from the collateral model) in conjunction with stressed prepayment rates and a compressed weighted average coupon according to rating scenario (Fitch's approach to modelling cash flow in RMBS transactions is further discussed in Appendix One and in the criteria report *"A Guide to Cash flow Analysis for RMBS in Europe"* dated 20 December 2002 and available at www.fitchratings.com).

■ Collateral Analysis

The figures provided in Fitch's collateral analysis are based on the maximum drawable balance for the flexible mortgages and consequently differ slightly from those in the Offering Circular.

Some 97.21% of the provisional pool analysed consisted of prime residential buy-to-let mortgage loans, while 2.77% consisted of prime owner-occupied mortgages, with a total outstanding balance of approximately GBP557.5 million (as at 31 March 2004). On or before the first interest payment date on 15 November 2004, further loans will be purchased using the retained pre-funding amount. The distinguishing characteristics of the portfolio are detailed below, together with commentary on any special considerations. All percentages are based upon the current balance of mortgages unless otherwise stated.

Buy to Let

Some 97.21% of the loans in the portfolio are buy-to-let loans. Fitch applies an additional default hit to these to reflect the fact that;

- 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.

However, Fitch notes that whilst the minimum required debt service coverage ratio ("DSCR"' expressed as rental income against mortgage repayment) is 120%, [89.68]% of the loan portfolio by value have DSCR ratios above 130% and [37.29]% by value have DSCR ratios above 200%. This would suggest that borrowers are protected to some degree from a potential reduction in rents.

Fitch notes too that the majority of borrowers in this portfolio are professional landlords, with a minimum of 12 months' experience of managing at least three properties and with a recognised aptitude for enforcing tenancy contracts. The remaining buy-to-let borrowers are emerging professional landlords, also with significant experience, who aim to stay in the market for the longer term. This is a mitigant in minimising any downtime between tenancies. Another mitigating feature of buy-to-let loans in general is that upon default, the foreclosure process is likely to be quicker than in other cases, as tenants with short-hold tenancy agreements can generally be more easily evicted than owner-occupiers, while the property can be repossessed more speedily. For a more detailed commentary, please refer to "*Origination*" on page 8.

Repayment Type

Some 79.82% of the pool are interest-only mortgages. Fitch applies a default stress to these loans, which reflects the increased risk of default at maturity due to the risk that the borrower may be unable to refinance the loan at this time.

Arrears Loans

In the provisional pool, 0.64% of loans by current balance are currently more than 30 days in arrears, of which 0.32% are over 90 days in arrears. Fitch assumes that loans in arrears are more likely to go into default, and applies more conservative default adjustments to these.

Interest Rate Type

Some 10.96% of loans by current balance are fixed rate for a pre-specified period, after which they revert to variable rate. All the fixed-rate loans in the provisional pool will have reverted at the latest by December 2009. While this may lead to a minor payment shock, Fitch does not believe this warrants any special adjustment to default probabilities. The remainder of the loans in the pool have interest rates linked via PML's SVR to LIBOR or Bank of England Base Rate.

The ratio of fixed- to variable-rate loans may change not only as a result of periods expiring, but also following the approval of borrowers' requests by the Administrator to convert their mortgages, see "*Interest Rate Risk*" above.

Conversion

Subject to certain conditions, the Administrator may approve borrower requests to convert certain aspects of their mortgages, for instance from a variable-rate loan to fixed or capped. To approve this change, the issuer would have to obtain the necessary cash in advance in order that it would be in a position to extend the then-current hedging facilities. This would be achieved either by trapping excess spread in advance or obtaining a loan from Paragon Finance PLC, whose subsequent claim would be in a subordinated position in the revenue waterfall.

Further Advances

Mandatory further advances are made to borrowers who have flexible mortgages and who have overpaid, or to those who have the right to obtain a further advance upon the completion of construction works or refurbishment to their properties. 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, recoveries or the subordinated loan, provided that:

- there was no debit balance on the PDL as at the previous interest payment date;
- the aggregate of (i) the issuer's maximum potential obligation – at closing – to fund mandatory further advances, and (ii) the maximum balance of discretionary and mandatory further advances made or being considered is 16% of the original principal balance;
- the reserve fund is at its required amount;
- in respect of discretionary further advances, the borrower has not been in arrears in the previous three months or in breach of the mortgage conditions; and
- the weighted average current loan-to-value of the portfolio would not exceed its value at closing by more than 1%.

Legal Structure

The PM7 legal structure is designed to ensure that a seller insolvency would not interrupt timely payments of principal and interest to investors.

On the closing date, the loan sellers will assign the rights, title and interest in and to the mortgages to PM7 (a public company incorporated under the laws of England and Wales). There will be no recourse to the sellers so that the transfer to PM7 will be treated as a true sale.

At closing, PM7 will enter into a deed of charge, creating security over the collateral in favour of the trustee as security for all payments under the notes. The security includes first lien mortgages and first fixed charges in favour of the trustee on all the issuer's rights, claims, title, benefit and interest in and to the underlying collateral.

Representations and Warranties

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

Specifically, the representations and warranties include the following:

- Each mortgage constitutes a first-ranking legal mortgage or a second-charge mortgage when either PML or MTL are holders of the first charge, which is a valid and binding obligation of the borrower, enforceable under its terms.

- No lien or right of set-off exists between the borrower and the originator.

- Each loan has been underwritten according to the originator's lending criteria outlined in the offering circular. This includes proper investigation and search of the relevant properties.

- Prior to granting the loan, a property valuation was conducted by PML's and MTL's in-house valuers or an independent valuer from the panel of valuers appointed by the originators.

- Each loan governed by the Consumer Credit Act 1974 meets the requirements of the Act in full.

- The maximum aggregate principal amount of arrears mortgages which may be purchased as at the date of purchase is GBP8 million.

- At its date of completion, each property was insured under a buildings policy or a block buildings policy.

- All loans were originated by PML or MT.

- All loans have received their first payment instalment.

Origination and Servicing

Paragon Mortgages Limited Origination

PML is a subsidiary of The Paragon Group of Companies, a group specialising in the provision of various financial products to consumers. As a mortgage company, PML specialises in the origination of buy-to-let products, and since February 2001, the vast majority of originations have been to so-called professional borrowers. To qualify for the benefits of such a loan – notably a higher LTV – a borrower must already possess a portfolio of at least three properties and must present at least 12 months of 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. PML insists that expected rental yields must exceed 120%, and ordinarily 130%, of the mortgage repayments on an interest-only basis. Interest rates have been stressed at LIBOR plus 1.50% for the purposes of this test.

PML has five levels of underwriting based on a hierarchy of mandates. To increase borrowings above these levels PML 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 GBP1 million, 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 buy-to-let lenders, PML prefers to retain human discretion in its lending procedures rather than adhere to a *pro forma* approach, and, as such, a hierarchy of mandates adhering to guidelines and criteria ensures that accountability is maintained. At the heart of policy-making is the overarching credit committee – comprising four standing members, department heads and other experts – which convenes on a monthly basis and which presides over any changes to criteria and special cases. Voting by department heads is restricted to departments other than their own, a segregation of duties that helps prevent "relationship-lending" factors influencing credit decisions.

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.

Mortgage Trust Origination

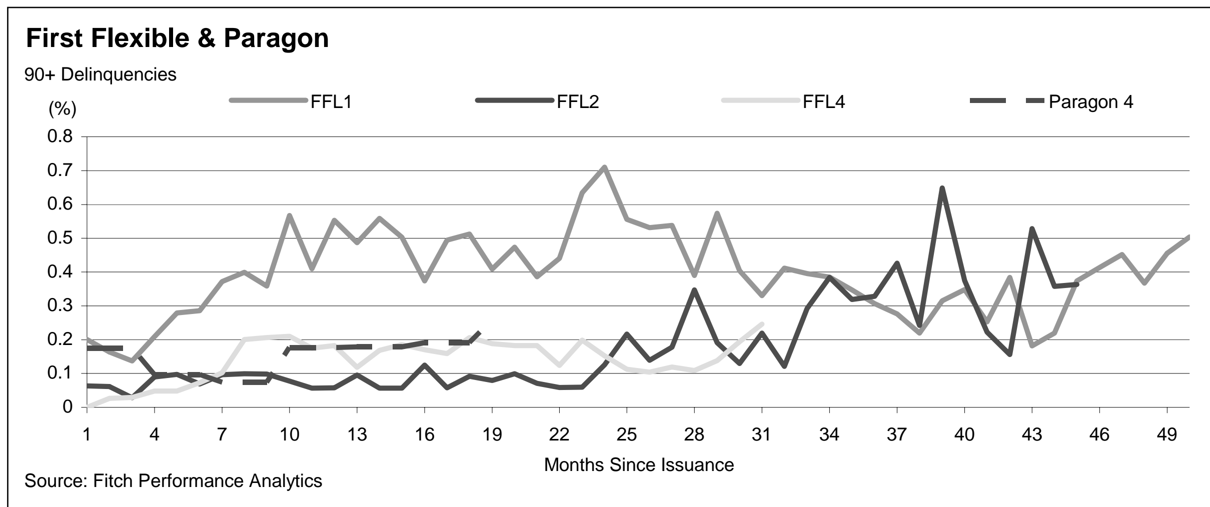
MTL, part of the Paragon Group of Companies since June 2003, launched its new brand in September 2003. MTL specialises in the origination of buy-to-let products, and the majority of originations are to emerging professional borrowers. These borrowers typically possess a portfolio of between two and five properties and are investing in the property market for the longer term. MTL borrowers are expected to have rental yields exceeding 120% of mortgage repayments on an interest-only basis. Interest rates have been stressed at LIBOR plus 1.50% for the purposes of this test.

Mortgages are originated via direct distribution centres and, indirectly, through a network of brokers. The underwriters at MTL have experience either in-house or with high street lenders. New hires follow a specific training/mentoring programme, after which they are gradually given increasing underwriting limits. Although underwriters follow the underwriting guidelines established by MTL, they are allowed certain "discretion points" based on their seniority/experience. This results in an application to completion rate of approximately 65%.

Servicing

Paragon Finance PLC is responsible for administering the mortgage loans in the PML-originated portion of the portfolio. It invested in sophisticated collections technology following the adverse credit experience suffered by the Group in the early 1990s. In a self-contained site at the Group's West Midlands base, 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 Paragon Finance PLC to be more than adequate in its role as servicer.

Mortgages Trust Services (as Servicer for the MTL-originated loans) has an experienced mortgage servicing operation. The systems developed are user-friendly and tailored specifically to the needs of securitisation. MTL's servicing and origination operations are located in Solihill. Collections and arrears management are now performed by Paragon Finance PLC, using PFPLC/MTS employees who



operate the same systems and processes as for the PML-originated mortgages.

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 requires 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.

This transaction features a standby servicer, GHL Mortgage Services Limited (GHLMSL), a subsidiary of Countrywide Credit Industries, Inc., and the largest third-party servicer in the UK, with over GBP60 billion of loans in administration. GHLL is contractually required to assume servicing responsibilities in the event that PFPLC is no longer able to continue servicing the portfolio.

■ Performance Analytics

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance surveillance team ensures that the assigned ratings remain, in the agency's view, an appropriate reflection of the issued notes' credit risk.

Details of the transaction's performance are available to subscribers at www.fitchresearch.com. Further information on this service is accessible at www.fitchratings.com.

Please call the Fitch analysts mentioned on the first page of this report for any queries regarding the initial analysis or the ongoing surveillance.

Appendix 1 – Rating Methodology

Model Approach

To determine loss coverage for RMBS, Fitch's default model employs a loan-by-loan review, examining several loan-, borrower-, lender- and property-specific factors that most influence default probability and loss severity. Fitch's base default probability analysis focuses primarily on the borrower's income multiple, in conjunction with the loan's LTV. These expected default rates are then adjusted further by loan, borrower, lender and property attributes. A large component of Fitch's loss severity analysis is market value trends. Fitch's market value assumptions focus on historical regional volatility and sustainable growth. Market value projections are then adjusted by loan and property attributes.

Default Probability Adjustments

Underwriting and Servicing Quality: When applying the default probability matrix, Fitch also considers a lender's underwriting and servicing guidelines. Fitch's views will be formed following a due diligence visit, where the lender's criteria and procedures regarding borrower income, LTV, borrower's past credit performance and many other factors will be considered. Fitch's review and analysis of the originator determines whether it decreases base default rates by up to 25% or increases them by up to 250%.

Investment Properties: Fitch's methodology in evaluating the default probability of a Buy-to-let ("BTL") portfolio is to use the UK residential default model, but with the following additional assumptions:

- For the base probability of default, BTL loans are assigned an affordability class based on underwriting criteria related to the minimum interest cover requirement. Generally speaking, Fitch will assign a high affordability class (meaning less affordable and thus a higher base probability of default) unless rental yields are estimated to exceed 150% of the mortgage payment, including principal, and are tested at a stressed interest rate.
- A loan-by-loan increase in base default probabilities by 25% for the fact that the properties are non-owner occupied.
- Increase in the underwriting quality factor to account for lack of experience in BTL. This factor also incorporates originator-specific issues related to underwriting criteria, historical experience as well as servicing capabilities.

Repayment Types: The most common repayment types in the UK market are repayment and interest-only mortgages. Interest-only mortgages are usually linked to some form of investment vehicle: either an endowment policy, a pension or Individual Savings Account ("ISA"), which are designed to repay the loan principal on maturity. The following factors should be noted:

- Repayment mortgages incur no default probability adjustment.
- Interest-only mortgages are susceptible to the payment shock associated with a "balloon" repayment for the entire principal at maturity. The borrower may be able to remortgage and thereby pay off their existing mortgage; however if their circumstances have changed this may not be possible. The further off the maturity date is, the more there is capacity for the borrower's circumstances to change. For this reason, Fitch applies an increased default factor to interest-only loans of between 1-1.33 depending upon the length of time to maturity.

Loan Purpose: Fitch does not penalise mortgage loans advanced to purchase a home or those advanced to refinance existing mortgage loans, nor loans to release equity for the purpose of home improvements. However, the agency views mortgage loans advanced to release equity in the home (equity refinance mortgages) in order to consolidate other existing debts (such as credit cards) as more risky by their nature. For this reason, Fitch applies an increased default factor of 1.1-1.25 depending on underwriting criteria for such loans.

Mortgages in Arrears: When rating a portfolio combining current and arrears mortgages, Fitch increases base default rates for mortgages in arrears up to 90 days by factors between 1.25 and 1.75. For mortgages that are in arrears for more than 90 days, Fitch assumes a 100% default probability.

Second Homes: While information about mortgage performance for second homes is limited, Fitch believes that second homes are considerably more susceptible to default. A financially distressed borrower is more likely to default on a second home than on their primary residence. Accordingly, Fitch increases base default by a factor of 1.1-1.25.

Right to Buy: Council tenants have the opportunity to purchase their own homes through the UK government's Right to Buy scheme. Available information suggests that there is a higher propensity to default. For this reason Fitch applies and increases default probability factor of between 1.1-1.25.

Product Type: Most UK RMBS issues are primarily backed by variable-rate mortgages. While variable-rate mortgages can experience payment shock due to underlying index volatility, this risk is usually gradual with ½-1% interest rate rises. Other mortgage types commonly available include initially fixed-rate mortgages and capped-rate mortgages, which reset to variable rate after a limited period. Although these loans may be more susceptible to payment shocks after the reset date (if rates have risen substantially during the fixed- or capped-rate period) Fitch believes this does not warrant a supplementary default factor. Other product types will be evaluated individually.

Loss Severity

Fitch's UK default model quantifies loss severity (or, conversely, recovery value) by focusing on several factors, including market value declines ("MVDs"), foreclosure and carrying costs, and LTV.

Market Value Declines: Fitch's MVD methodology focuses on three key factors: the volatility of observed prices from the long-term trend; historical levels of stress experienced in the housing market of each region; and the current position of the index relative to the long-term trend.

For example, the MVDs for East Anglia, London and the South East are highest, reflecting high historical volatility and current prices well above the long-term trend line. The MVD for Scotland is lowest, reflecting low historical volatility and current prices slightly below the long-term trend line.

Indexing of Property Valuation: Fitch's model uses a conservative index to adjust original property values depending on the year of valuation. The index is based on information obtained from sources in the mortgage industry and considers both the year of valuation and the region in which the property is located. Where there has been capital appreciation, this is a mitigating factor in the calculation of loss severity but will be offset by higher MVDs assigned to regions that have seen above-average price appreciation.

High- and Low-Value Properties: Homes with relatively high or relatively low market values are generally subject to higher MVDs in a deteriorating market than homes with average market values due to limited demand for such properties. Imprecise pricing information, caused by the lack of comparable benchmark homes in the case of high-value properties, also influences the amount of price volatility during a market downturn. The market value thresholds are increased periodically to reflect the increase in housing prices. Adjustments for high- and low-value properties are split between London and the rest of the country due to higher prices in London, and the differential between what would constitute a high- or low-value property.

Mortgage Indemnity Guarantee (MIG) Policies: Many lenders require borrowers to pay for MIG for that portion of their mortgage loan which exceeds a certain LTV level (usually 75%). In case of default by the borrower, the lender will be able to recover any loss on the portion of the loan in excess of that LTV limit (subject to any policy deductions) from the MIG provider. Fitch will give credit for MIG on a case-by-case basis. The agency will review the MIG policies to determine the extent of coverage and payment terms and to determine whether there are any exclusion clauses which might lead to non-payment of claims by the insurer. The insurer's rating is also taken into consideration when determining the amount of credit to be given for MIG.

Geographic Concentration: Fitch also assumes that a mortgage portfolio is generally broadly diversified in geographical terms. A particular region might be more sensitive to economic downturns and/or other negative developments in the property and mortgages market than others. If a portfolio has significant regional concentrations, Fitch will make adjustments on a case-by-case basis. As a general rule, for pools with high concentrations in specific regions, the credit enhancement necessary for a particular rating level will be higher than for geographically diversified portfolios.

Foreclosure and Carrying Costs: when calculating recovery value, Fitch's model reduces the property valuation by foreclosure costs and the cost to the administrator of "carrying" the loan from delinquency through to default. Fitch assumes foreclosure costs amount to 5% of the sale price at the time of foreclosure. This estimate is based on actual cost data supplied to Fitch, and may be adjusted as cost structures change in the industry and jurisdiction.

To calculate carrying costs, Fitch assumes the borrower does not pay interest for 18 months in the case of a residential property and 12 months in the case of an investment property. The interest rate used reflects the need to continue to service the notes during the period that the defaulted loans are not generating any revenue. The 18- and 12-month time frames are based on worst-case estimates obtained from UK mortgage lenders.

■ Paragon Mortgages (no. 7) PLC RMBS/UK

Capital Structure

Class	Rating	Size (%)	Size(GBPm)	CE (%)	Spread	PMT Freq	Maturity	Coupon	ISIN
A	AAA	90	720	12.2	[•]bps	Qtrly	2034	[•]	[•]
B	A	10	80	2.2	[•]bps	Qtrly	2043	[•]	[•]

	Size (%)	Size (GBPm)
Cash Reserve	2.2	17.6
Step Up Date	May 2010	

AAA 90% | A 10%

Key Information

Expected closing Date	26 May 2004	**Parties**	
Country of Assets	United Kingdom	**Seller/Originator**	Paragon Mortgages PLC and Master Trust Limited
		Servicer	Paragon Finance PLC and Mortgage Trust Services
Structure	Pass Through		
Bloomberg	[•]	**Joint Lead Managers**	Barclays Capital and The Royal Bank of Scotland ('AA+/F1+)
Settlement	Clearstream & Euroclear	**Standby Mortgage Administrator**	Global Home Loans Limited
Listing	Luxembourg Stock Exchange	**Basis Hedge Provider**	JP Morgan Chase bank ('A+/F1')
Analyst	Fionnuala Connolly	**Currency Swap Provider**	The Royal Bank of Scotland
	Fionnuala.connolly@fitchratings.com	**Trustee**	Citicorp Trustee Company Limited
	+44 20 7417 4354	**Account Bank**	National Westminster Bank ('AA+/F1+') for PML and Barclays Bank PLC ('AA+/F1+') for MTL

Others (Summary)

Short Term Rating Triggers (Minimum)

Swap Counterparty	F1

Structure

Separate revenue and principal waterfalls to repay principal and interest on the notes

Principal can be used to pay interest on the senior notes. Such a payment will be recorded on the PDL and repaid from available funds.

The reserve fund is fully funded at closing but will increase to 2.9% upon certain events.

Credit Committee Highlights

The portfolio is contains two called transactions: Paragon Mortgages (no 1) and Finance for People No. 4 – both called in April 2004.

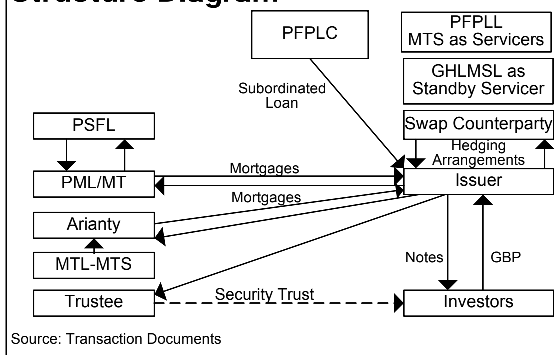
97.21% of the portfolio is comprised of buy to let mortgages

Discounted loans not collateralised

4.6% of the portfolio is comprised of flexible mortgages

Fitch Default Model Output

Rating Level	AAA	AA	A	BBB
WAFF (%)	27.30	21.91	16.51	11.11
WARR (%)	72.13	77.03	81.67	86.24
Loss Severity (%)	33.46	28.56	23.93	19.38
MVD	44.65	40.34	36.03	31.63



Collateral– inclusive of maximum drawable balance. The current securitised portfolio excluding the maximum drawable balance totals GBP557,171,810 with a WA original LTV of 75.84%

Pool Characteristics

Current Principal Balance (GBP)	557,513,911	**Regional Concentration (%)**	
Average Current Loan per Borrower (GBP)	76,782	London	23.71
Number of Loans	7,261	Outer Metro	8.41
Seasoning (Months)	23.09	South East	11.98
Loan to Value (LTV) (%)		North West	13.11
WA OLTV	75.81	Yorks and Humber	12.41
WA Indexed CLTV	70.54		
Mortgage Characteristics		First Ranking (%):	100
Self Certification Loans	0.63		
CCJs	0.00		
Bankruptcy Order/IVA	0.00	Owner Occupied	2.77
Less Liquid Properties[1]	25.54	Buy to Let	97.21
Interest Only Loans	79.82	Right to Buy	0.02
Interest Rate Type		Consolidation	0.00
Capped Rate Loans (%)	0.08		
Fixed Rate Loans (%)	10.96	**Arrears**	
Other (%)	88.96	31-60 days	0.26
WA Interest Margin (%)	1.55	61-90 days	0.06
Interest Index (Libor)	Libor	> 90 days	0.32

[1] Particularly large or small properties at less liquid extremes of market
[2] Geographic distribution is calculated using Nationwide index
Source: Fitch, Pool cut of 31 March 2004 provided by Paragon Mortgages PLC.

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