

FITCH AFFIRMS 59 TRANCHES OF PARAGON RMBS SERIES; DOWNGRADES THREE

Link to Fitch Ratings' Report: Fitch Affirms 59 tranches of Paragon RMBS series; Downgrades 3
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=706462

Fitch Ratings-London-16 April 2013: Fitch Ratings has affirmed 59 tranches and downgraded three tranches of 11 transactions originated by Paragon Mortgage Limited, Mortgage Trust Limited and Paragon Personal Finance Limited, all subsidiaries of The Paragon Group. Fitch has also revised the Outlooks on nine tranches to Negative from Stable.

The series comprises 10 Paragon buy-to-let (BTL) deals and one non-conforming RMBS transaction, Paragon Secured Finance (PSF1), which comprises 99.9% of second-charge loans. A full list of rating actions is available at www.fitchratings.com or by clicking the link above.

KEY RATING DRIVERS

Arrears Performance for 10 BTL Transactions Within Expectations

The portion of borrowers in the three-month plus arrears bucket has remained low in all 10 transactions. As of the most recent interest payment dates, three-month plus arrears ranged between 0.21% (Paragon 10) and 0.66% (Paragon 11) of the current portfolio, while no arrears were reported for Paragon 16 and 17.

Given the BTL nature of the underlying pools, borrowers in arrears by more than three months are predominantly managed by Paragon via its receiver of rent policy, where the full rental stream it receives from properties is diverted onto Paragon as administrator towards clearing arrears. Fitch acknowledges that Paragon's extensive use of its receiver of rent policy has contributed towards the low level of arrears across the series - where performing loans under this policy are excluded from published arrears figures. At present, the portion of loans receiving receiver of rent ranges from 2.26% (Paragon 15) to 3.68% (Paragon 10) of the portfolio.

The agency remains cautious about the possibility of these types of performing loans falling back into arrears, particularly in an increased interest rate environment. For this reason, the agency has taken a more conservative stance in its treatment of receiver of rent cases by increasing its default probability assumption.

Robust Excess Spread Levels

The volumes of properties being repossessed and sold are relatively unchanged compared with a year ago. Subsequently, healthy levels of annualised excess spread generated in each of the BTL transactions, averaging 1.2% of the respective outstanding portfolio, have remained sufficient to cover associated losses and to ensure the reserve funds have remained fully funded in all transactions.

Increased Quick Sale Assumption (QSA) Based on Loan Level Repossession Data

Based on the analysis of loan level repossession data previously provided by Paragon, the agency applied an increased QSA of 32%, compared with the standard assumption of 22%, which has resulted in lower recovery rate assumptions being applied to these BTL loans.

Insufficient Credit Enhancement Levels

Paragon 14's class C1a and C1b notes and associated currency swap have been downgraded due to the low levels of credit enhancement, which the agency deems as no longer being commensurate with their ratings. Additionally, this is supported by relatively volatile loss severities in the transaction. The Outlooks on the class C1b notes in Paragon 11 and 15 and class C1a and C1b notes in Paragon 12 and Paragon 13 have been revised to Negative from Stable, reflecting the slow build-up in credit enhancement levels in these deals caused by low prepayment rates.

Stable Arrears Performance in PSF1

The affirmation of PSF1 reflects the robust performance over the past year. As of January 2013, loans in arrears by more than three months stood at 10.4% of the current outstanding portfolio, compared with 9.9% a year ago. Additionally, the transaction's structure allows for the full provisioning of defaulted loans (defined as loans in arrears by more than 12 months). At present, robust levels of annualised excess spread, standing at 7.5% of the outstanding collateral balance, have enabled the issuer to comfortably clear defaults, without having to draw on its reserve fund.

RATING SENSITIVITIES

A moderate rise in interest rates could lead to a rise in three-month plus arrears levels and potentially result in an increase in defaults. Additionally, a decrease in future house prices could exacerbate a decline in recovery rates.

Contact:

Lead Surveillance Analyst

Grace Yeo

Analyst

+44 20 3530 1486

Fitch Ratings Limited

30 North Colonnade

London E14 5GN

Secondary Analyst

Michal Kiska

Trainee Analyst

+44 20 3530 1275

Committee Chairperson

Gregg Kohansky

Managing Director

+44 20 35301376

Media Relations: Sandro Scenga, New York, Tel: +1 212-908-0278, Email: sandro.scenga@fitchratings.com.

Additional information is available at www.fitchratings.com.

Individual Representations, Warranties, and Enforcement Mechanisms reports are available for all structured finance transactions initially rated on or after 26 September 2011 at www.fitchratings.com.

Sources of information - in addition to those mentioned in the applicable criteria, the sources of information used to assess the ratings were Investor and Servicer reports and loan-by-loan data provided by the servicer.

Applicable criteria 'Global Structured Finance Rating Criteria', dated 06 June 2012, 'EMEA Residential Mortgage Loss Criteria' dated 7 June 2012; 'EMEA Residential Mortgage Loss Criteria Addendum - United Kingdom' dated 9 August 2012; 'Counterparty Criteria for Structured Finance Transactions' and 'Counterparty Criteria for Structured Finance Transactions: Derivative Addendum', dated 30 May 2012; 'Criteria for Servicing Continuity Risk in Structured Finance', dated 10 August 2012; 'Criteria for Rating Swap Obligations of an SPV in Structured Finance Transactions', dated 8 August 2012 are available at www.fitchratings.com.

Applicable Criteria and Related Research

Global Structured Finance Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=679923

EMEA Residential Mortgage Loss Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=681096

EMEA Criteria Addendum - United Kingdom - Mortgage and Cashflow Assumptions
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685433
Counterparty Criteria for Structured Finance Transactions: Derivative Addendum
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=678939
Criteria for Servicing Continuity Risk in Structured Finance
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685875
Criteria for Rating Currency Swap Obligations of an SPV in Structured Finance Transactions
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685879
Counterparty Criteria for Structured Finance Transactions
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=678938

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.