



## Fitch Takes Rating Actions on Paragon RMBS Series

[Link to Fitch Ratings' Report: Fitch Takes Rating Actions on Paragon RMBS Series \(https://www.fitchratings.com/site/re/895808\)](https://www.fitchratings.com/site/re/895808)

Fitch Ratings-London-17 March 2017: Fitch Ratings has upgraded 7 tranches, downgraded 5 tranches and 4 currency swap obligations and affirmed 61 tranches and 4 currency swap obligations of the Paragon RMBS series. A full list of rating actions is available at [www.fitchratings.com](http://www.fitchratings.com) or by clicking the link above.

The series is backed by loans originated by Paragon Mortgage Limited, Paragon Mortgages (2010) Limited and Mortgage Trust Limited, all subsidiaries of The Paragon Group. It comprises 13 Paragon buy-to-let (BTL) deals and one non-conforming RMBS transaction, Paragon Secured Finance (PSF1), which is fully backed by second-charge loans.

The Criteria for Rating Currency Swap Obligations of an SPV in Structured Finance Transactions and Covered Bonds expects that a rating action with respect to a note tranche results in a corresponding rating action with respect to the related rated swap obligations.

### KEY RATING DRIVERS

#### Stable Asset Performance

Loans with more than three unpaid monthly instalments have remained stable over the 12 months prior to the last reporting dates, when they ranged from 0% (Paragon 22 to 24) to 0.5% (Paragon 20) of the current portfolio balance, while Fitch's UK All Buy-To-Let Index was 1%. 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 is diverted to Paragon, as administrator, and used towards clearing arrears. Paragon's extensive use of its receiver of rent policy has therefore contributed towards the low level of delinquencies across the series.

The cumulative balance of loans taken into possession has also remained stable and was reported between 0% (Paragon 22 to 24) and 3% of the original portfolio balance (Paragon 7), an average increase of 11bps over the last 12 months. The limited arrears pipeline, combined with contained foreclosures, contributes to the Stable and Positive Outlooks across the series.

As of January 2017, PSF1's late stage arrears were reported at 9.3% (-1.2pp yoy), 90bps above the Fitch UK Non-Conforming Index. Cumulative losses have increased by only 17bps since January 2016. In Fitch's view, the robust gross excess spread generated by the structure (8.8%, annualised) will continue to be sufficient to cover these losses.

#### Stressed QSA Assumptions

Based on the analysis of loan level data provided by Paragon on properties taken into possession and sold, the agency applied a quick sale adjustment (average 35%) higher than the criteria assumption (31%). Fitch's analysis showed that the current credit enhancement (CE) was sufficient to withstand the lower recoveries.

#### Counterparty Exposure

The CE available to the junior notes in Paragon 7, 8, 10, 11, 12, 13, 14 and 15 is solely provided by the First Loss Funds, which can be either invested in Authorised Investments or held in the Transaction Account at Barclays (A/Stable/F1), in accordance with the terms and conditions of each securitisation. In Fitch's view, a credit link to the Long-term Issuer Default Rating (IDR) of Barclays exists, hence the decision to cap the rating of the junior notes in Paragon 8, 10, 11, 12, 13 at 'Asf'.

The currency swap provider in Paragon 7 (Royal Bank of Scotland (RBS); BBB+/Stable/F2) is posting collateral below that suggested by Fitch's current counterparty criteria for structured finance transactions. Fitch concluded that the amount posted is sufficient to withstand Class A ratings above the derivative provider's IDR. Conversely, Class B ratings have been capped at the Long-term Issuer Default Rating of RBS as the credit link to the bank is deemed material.

#### Excess Spread Reductions

The Paragon deals feature loans linked to the Bank of England Base Rate (BBR) and Paragon's Standard Variable Rate (SVR). The mismatch between the three-month Libor payable on the notes and the variable rates paid on the underlying loans is not hedged in these transactions. Consequently, the agency adjusted the transaction's excess spread by assuming Paragon's SVR (5.1%) is reduced to three-month Libor plus 2.6%. For BBR-linked loans the weighted average spread on the BBR paying loans was reduced by 50bps. The analysis results have shown that current ratings were relatively insensitive to these stresses.

#### Sufficient CE

The stable asset performance, together with non-amortising reserve funds has contributed to a steady build-up of CE, which

resulted in the upgrade of the class B notes of Paragon 13, 15, 19 and 20 and of the class C notes in Paragon 19.

#### Paragon 10 and 14 class A1 Short-Term Rating Withdrawn

Paragon 10, 11, 12 and 14 class A1 notes were subject to a remarketing agreement and a conditional purchase agreement intended to facilitate their eligibility for purchase by money market funds. The note tranches were structured to be issued on an annual, revolving basis. Unless noteholders exercised their right to retain the notes, they would be automatically tendered for remarketing. The remarketing bank would then first try to sell the notes in the open market or, if unsuccessful, would require the conditional purchaser to acquire them. Ultimately, the short-term ratings on these notes reflect the ability of the conditional purchaser to acquire them every year.

Paragon 12 class A1 notes are still subject to their annual remarketing and as such, we have affirmed their Short-term ratings in line with the Short-term rating of the respective conditional note purchaser.

We received written notice that Paragon 10, Paragon 11 and Paragon 14 A1 Note Conditional Purchaser has purchased the notes on 15 September 2016, 15 January 2017 and 15 December 2016, respectively.

The conditional repurchase of the Class A1 notes of Paragon 10, Paragon 11 and Paragon 14 triggered a remarketing termination event. As a result, Short-term ratings are no longer applicable and have been withdrawn.

#### Error Resolved

During the course of completing the 2017 annual review of these transactions, Fitch identified erroneous data entries in its models regarding relevant loan margins which affected the 17 March 2016 Paragon 22 and Paragon 23 rating action. Today's rating action corrects these data entry inconsistencies.

#### RATING SENSITIVITIES

The rating of the junior notes in Paragon 8, 10, 11, 12, 13 is capped at Barclays's IDR. Any changes in the bank's Issuer Default Rating may result in rating actions on these notes.

Paragon 7's currency swaps are in Fitch's view under-collateralised. As a result, the class B ratings have been capped at the swap provider's IDR. Any changes in the bank's Issuer Default Rating may result in rating actions on these notes.

#### USE OF THIRD-PARTY DUE DILIGENCE PURSUANT TO RULE 17G-10

Form ABS Due Diligence-15E was not provided to, or reviewed by, Fitch in relation to this rating action.

#### DATA ADEQUACY

Fitch has checked the consistency and plausibility of the information it has received about the performance of the asset pools and the transactions. There were no findings that affected the rating analysis. Fitch has not reviewed the results of any third party assessment of the asset portfolio information or conducted a review of origination files as part of its ongoing monitoring.

#### Relevant for PSF1 to Paragon 15:

Fitch did not undertake a review of the information provided about the underlying asset pools ahead of the transactions' initial closing. The subsequent performance of the transactions over the years is consistent with the agency's expectations given the operating environment and Fitch is therefore satisfied that the asset pool information relied upon for its initial rating analysis was adequately reliable.

#### Relevant for Paragon 19 to Paragon 24:

Prior to the transactions' closing, Fitch reviewed the results of a third party assessment conducted on the asset portfolio information, which indicated no adverse findings material to the rating analysis. Prior to the transactions' closing, Fitch conducted a review of a small targeted sample of Paragon's origination files and found the information contained in the reviewed files to be adequately consistent with the originator's policies and practices and the other information provided to the agency about the asset portfolios.

Overall, Fitch's assessment of the information relied upon for the agency's rating analysis according to its applicable rating methodologies indicates that it is adequately reliable.

#### SOURCES OF INFORMATION

The information below was used in the analysis.

- Transaction reporting provided by Paragon as at December 2016 (Paragon 10, 14, 15 and 22), January 2017 (Paragon 8, 11, 13, 23 and 24) and February 2017 (PSF 1, Paragon 7, 12, 19 and 20).

- Loan-by-loan data provided by Paragon as at November 2016 (Paragon 10, 14, 15 and 22), December 2016 (Paragon 8, 11,

13, 23 and 24) and January 2017 (PSF 1, Paragon 7, 12, 19 and 20).

- Sold repossessions data provided by Paragon as at March 2017.

#### MODELS

The models below were used in the analysis. Click on the link for a description of the model.

#### ResiEMEA

ResiEMEA. (<https://www.fitchratings.com/site/structuredfinance/rmbs/resiemea>)

#### EMEA RMBS Surveillance Model

EMEA RMBS Surveillance Model. (<https://www.fitchratings.com/site/structuredfinance/rmbs/emearsm>)

#### EMEA CashFlow Model

EMEA Cash Flow Model. (<https://www.fitchratings.com/site/structuredfinance/emeacfm>)

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

#### Applicable Criteria

Counterparty Criteria for Structured Finance and Covered Bonds (pub. 01 Sep 2016)

(<https://www.fitchratings.com/site/re/886006>)

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum (pub. 18 Jul 2016)

(<https://www.fitchratings.com/site/re/884964>)

Criteria Addendum: UK Residential Mortgage Assumptions (pub. 03 Feb 2017) (<https://www.fitchratings.com/site/re/893726>)

Criteria for Rating Currency Swap Obligations of an SPV in Structured Finance Transactions and Covered Bonds (pub. 11 Aug 2016)

(<https://www.fitchratings.com/site/re/885925>)

EMEA RMBS Rating Criteria (pub. 29 Nov 2016) (<https://www.fitchratings.com/site/re/891276>)

Global Structured Finance Rating Criteria (pub. 27 Jun 2016) (<https://www.fitchratings.com/site/re/883130>)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 17 Feb 2017)

(<https://www.fitchratings.com/site/re/893890>)

#### Related Research

Paragon Mortgages (NO. 19) PLC - Appendix (<https://www.fitchratings.com/site/re/741495>)

Paragon Mortgages (No.20) plc - Appendix (<https://www.fitchratings.com/site/re/752484>)

Paragon Mortgages (No.22) PLC - Appendix (<https://www.fitchratings.com/site/re/863959>)

Paragon Mortgages (No.23) PLC - Appendix (<https://www.fitchratings.com/site/re/868941>)

Paragon Mortgages (No.24) PLC – Appendix (<https://www.fitchratings.com/site/re/873885>)

#### Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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