

RATING ACTION COMMENTARY

Fitch Affirms Paragon Mortgages No. 10, 11 and 13; Maintains Class C Notes on RWN

Wed 12 Aug, 2020 - 11:38 AM ET

Fitch Ratings - London - 12 Aug 2020: Fitch Ratings has affirmed Paragon Mortgages No. 10, 11 and 13, except for the class C notes, which remain on Rating Watch Negative (RWN). A full list of rating actions is below.

RATING ACTIONS

ENTITY/DEBT	RATING
Paragon Mortgages (No. 13) Plc	
● Class A1 XS0272533935	LT AAAsf Rating Outlook Stable Affirmed

ENTITY/DEBT	RATING		
● Class A2a XS0272534313	LT	AAAsf Rating Outlook Stable	Affirmed
● Class A2b XS0272534584	LT	AAAsf Rating Outlook Stable	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

In relation to Paragon Mortgages No. 11 C1b-CSO, Fitch's Global Structured Finance Rating Criteria expect a rating action on a note tranche to result in a corresponding rating action on the related rated swap obligations.

TRANSACTION SUMMARY

Paragon Mortgages No.10, 11 and 13 are buy-to-let (BTL) RMBS transactions backed by loans originated between 2005 and 2006 by Paragon Mortgages Limited and Mortgage Trust Limited, all subsidiaries of The Paragon Banking Group.

KEY RATING DRIVERS

RWN Maintained for Junior Notes

On 22 April 2020 Fitch placed the class C notes of Paragon 10, 11 and 13 on RWN following the placement of Barclays Bank plc (Barclays), the transaction bank account holder, on RWN. Credit enhancement (CE) available to the junior notes of Paragon 10, 11 and 13 is only provided by the first loss fund, which can either be invested in authorised investments or be held in the transaction account at Barclays. In Fitch's opinion, these notes are credit-linked to and therefore capped at Barclays' 'A+' Long-Term Issuer Default Rating (IDR). The RWN on Barclays was maintained on 29 May 2020 and will be reviewed within the next six months; this could trigger an event-driven rating action on the junior notes.

Coronavirus-related Additional Assumptions

We expect a generalised weakening in borrowers' ability to keep up with mortgage payments due to the economic impact of the coronavirus pandemic and the related containment measures. As a result, Fitch applied coronavirus assumptions to the mortgage portfolio.

The combined application of revised 'Bsf' representative pool weighted average foreclosure frequency (WAFF), revised rating multiples and arrears adjustment resulted in a multiple to the current FF assumptions in a range of 1.22x to 1.31x at 'Bsf' and of about 1.02x at 'AAAsf' in each transaction. The coronavirus assumptions are more modest for higher rating levels as the corresponding rating assumptions are already meant to withstand more severe shocks.

Borrowers on payment holiday in Paragon 10, 11 and 13 represented 26.1%, 16.7% and 15.8% of the portfolio as of May 2020 (Paragon 10) and June 2020 (Paragon 11 and 13), respectively. Payment holidays in Paragon transactions are in line with those observed among peers in the BTL sector. Fitch applied a payment holiday stress for the first six months of projections, assuming up to 30% of interest collections will be lost, and related principal receipts will be delayed. Fitch does not view payment holidays as a liquidity risk in these transactions.

Stable Asset Performance to Date

Loans with arrears greater than three months have remained stable over the last 12 months ranging from 0.12% (Paragon 11) to 0.35% (Paragon 13) of the current portfolio balance as of May 2020 and June 2020, respectively. Given the BTL nature of the underlying pools, borrowers in arrears by more than two 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. The extensive use of its receiver of rent policy has therefore contributed towards the low level of delinquencies across the series.

Despite the stable performance to date Fitch expects deterioration in asset performance as described above and applied coronavirus assumptions to the mortgage portfolio including an adjustment to the arrears in the pool.

BTL Interest-Only Concentration

The transactions have a material concentration of interest-only (IO) loans maturing within a three-year period during the lifetime of the transactions, peaking at 54.7%,

48.1% and 44.8% between 2028 and 2032 for Paragon 10, between 2029 and 2031 for Paragon 11, and between 2031 and 2033 for Paragon 13. Where concentration is present, Fitch will derive IO concentration's WAFF and apply in the analysis the higher of IO concentration WAFF and the standard portfolio WAFF for each rating level. For these pools Fitch has applied the FF based on the IO concentration WAFF.

RATING SENSITIVITIES

Downgrade Rating Sensitivity to Coronavirus-Related Stresses

The broader global economy remains under stress due to the coronavirus pandemic, with surging unemployment and pressure on businesses stemming from social-distancing guidelines. Recent government measures related to the coronavirus pandemic introduced a suspension on tenant evictions for three months and mortgage payment holidays, also for up to three months. Fitch acknowledges the uncertainty of the path of coronavirus-related containment measures and has therefore considered more severe economic scenarios.

As outlined in "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases", Fitch considers a more severe downside coronavirus scenario for sensitivity purposes whereby a more severe and prolonged period of stress is assumed with a halting recovery from 2Q21. Under this scenario, Fitch assumed a 15% increase in WAFF and a 15% decrease in WARR. The results indicate downgrades of no more than one notch in Paragon 10 class C notes, two notches in Paragon 11 class B notes and Paragon 13 class C notes and five notches in Paragon 13 class B notes.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The transactions' performance may be affected by changes in market conditions and economic environment. Weakening asset performance is strongly correlated to increasing levels of delinquencies and defaults that could reduce CE available to the notes.

Additionally, unanticipated declines in recoveries could also result in lower net proceeds, which may make certain note ratings susceptible to potential negative rating actions depending on the extent of the decline in recoveries. Fitch conducts

sensitivity analyses by stressing both a transaction's base-case FF and RR assumptions, and examining the rating implications on all classes of issued notes.

The class C notes of Paragon 10, 11 and 13 are capped at Barclays' Long-Term IDR, which is currently on RWN, heightening an increased probability of a negative rating change.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The ratings for all classes of notes are currently at their respective highest achievable ratings.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Structured Finance transactions have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of seven notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of seven notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAAsf' to 'Dsf'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

USE OF THIRD PARTY DUE DILIGENCE PURSUANT TO SEC 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.

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.

Overall and together with the assumptions referred to above, 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.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

The junior notes of Paragon 10, 11 and 13 are credit linked to Barclays' 'A+' Long-Term IDR.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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APPLICABLE CRITERIA

[Fitch Ratings Interest Rate Stress Assumptions for Structured Finance and Covered Bonds \(Excel\) \(pub. 06 Dec 2019\)](#)

[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 06 Dec 2019\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 29 Jan 2020\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 29 Jan 2020\)](#)

[Global Structured Finance Rating Criteria \(pub. 17 Jun 2020\) \(including rating assumption sensitivity\)](#)

[Fitch's Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance - Supplementary Data File](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Multi-Asset Cash Flow Model, v2.8.0 (1)

ResiGlobal Model: UK, v1.2.1 (1)

ADDITIONAL DISCLOSURES

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ENDORSEMENT STATUS

Paragon Mortgages (No. 10) Plc	EU Issued
Paragon Mortgages (No. 11) Plc	EU Issued
Paragon Mortgages (No. 13) Plc	EU Issued

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