

**RATING ACTION COMMENTARY**

# Fitch Affirms Paragon Mortgages No. 12, 14 and 15; Maintains RWN on 2 Junior Notes

Wed 12 Aug, 2020 - 11:39 AM ET

Fitch Ratings - London - 12 Aug 2020: Fitch Ratings has affirmed Paragon Mortgages No. 12, 14 and 15, except for the class C notes of Paragon No. 12 and 14, which remain on Rating Watch Negative (RWN). A full list of rating actions is below.

**RATING ACTIONS**

ENTITY/DEBT	RATING	P
Paragon Mortgages (No. 15) PLC		
● Class A1 XS0310510960	LT AAAsf Rating Outlook Stable	Affirmed A C S

ENTITY/DEBT	RATING			P
● Class A2a XS0310515258	LT	AAAsf Rating Outlook Stable	Affirmed	A C S
● Class A2b XS0310515504	LT	AAAsf Rating Outlook Stable	Affirmed	A C

[VIEW ADDITIONAL RATING DETAILS](#)

In relation to Paragon Mortgages No. 12, 14 and 15 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.12, 14 and 15 are buy-to-let (BTL) RMBS transactions backed by loans originated between 2005 and 2007 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 12 and 14 on RWN following the placement on RWN of Barclays Bank plc (Barclays), the transaction bank account holder. Credit enhancement (CE) available to the junior notes of Paragon 12, 14 and 15 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). However, the junior notes in Paragon 15 are currently rated below Barclays' IDR and are therefore not constrained by this cap. 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 of the affected transactions.

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 12, 14 and 15 represented 19.6%, 19.4% and 18.8% of the portfolio balances as of April 2020 (Paragon 12) and May 2020 (Paragon 14 and 15), 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 0.16% (Paragon 15) to 0.45% (Paragon 14) of the current portfolio balance as of May 2020. 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 pools.

#### 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 44.6%,

53.1% and 53.5% between 2029 and 2031 for Paragon 12, and between 2030 and 2032 for both Paragon 14 and 15. 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 up to two notches in Paragon 12 class B notes, three notches in Paragon 12 and 14 class C notes and no more than one notch in Paragon 15 class C notes.

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

The transaction's 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 the Paragon 12 and 14 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 rating positive action/upgrade:

The ratings for Paragon 12 and 14 notes are currently at their highest ratings on Fitch's rating scale. Stable to improved asset performance driven by stable delinquencies and defaults would lead to increasing CE and potential upgrades for class C notes of Paragon 15. Fitch tested an additional rating sensitivity scenario by applying a decrease in the FF of 15% and an increase in the RR of 15%, which could lead to an upgrade of the class C notes of Paragon 15 by up to two notches.

## **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 12, 14 and 15 are credit-linked to and capped at Barclays' 'A+' Long-Term IDR. However, the class C notes in Paragon 15 are currently rated below Barclays' IDR and are therefore not constrained by this cap.

## **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](http://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 \(pub. 29 Jan 2020\)](#)

[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 06 Feb 2020\)](#)

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

## **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. 12) Plc	EU Issued
Paragon Mortgages (No. 14) PLC	EU Issued
Paragon Mortgages (No. 15) PLC	EU Issued

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