



## RATING ACTION COMMENTARY

# Fitch Affirms Paragon Mortgages No. 12

Mon 22 Aug, 2022 - 11:59 AM ET

Fitch Ratings - London - 22 Aug 2022: Fitch Ratings has affirmed Paragon Mortgages (No. 12) Plc and removed the class C notes from Under Criteria Observation (UCO) as detailed below.

## RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
Paragon Mortgages (No. 12) Plc		
Class A1 XS0261644941	LT AAAsf Rating Outlook Stable  Affirmed	AAAsf Rating Outlook Stable
Class A2a XS0261646136	LT AAAsf Rating Outlook Stable  Affirmed	AAAsf Rating Outlook Stable

Class A2b XS0261646565	LT	AAAsf Rating Outlook Stable	AAAsf Rating Outlook Stable
		Affirmed	
Class A2c 69913BAB2	LT	AAAsf Rating Outlook Stable	AAAsf Rating Outlook Stable
		Affirmed	
Class B1a XS0261647886	LT	AAAsf Rating Outlook Stable	AAAsf Rating Outlook Stable
		Affirmed	
Class B1b XS0261648850	LT	AAAsf Rating Outlook Stable	AAAsf Rating Outlook Stable
		Affirmed	
Class C1a XS0261650161	LT	A+sf Rating Outlook Stable	A+sf Rating Outlook Stable
		Affirmed	
Class C1b Currency Swap Obligations	LT	A+sf Rating Outlook Stable	A+sf Rating Outlook Stable
		Affirmed	
Class C1b XS0261650674	LT	A+sf Rating Outlook Stable	A+sf Rating Outlook Stable
		Affirmed	

#### [VIEW ADDITIONAL RATING DETAILS](#)

For Paragon 12's class C1b-currency swap obligations, a rating action on a note tranche will result in a corresponding rating action on the related rated swap obligations as per Fitch's Global Structured Finance Rating Criteria.

#### **TRANSACTION SUMMARY**

Paragon 12 is a buy-to-let RMBS transaction backed by loans originated between 2005 and 2007 by Paragon Mortgages Limited and Mortgage Trust Limited, subsidiaries of The Paragon Banking Group.

## KEY RATING DRIVERS

**Under Criteria Observation:** The rating actions reflect the removal of the class C notes from UCO. Under its latest UK RMBS Rating Criteria published on 23 May 2022, Fitch updated its sustainable house prices for each of the 12 UK regions. The changes resulted in increased regional multiples for all regions other than North East and Northern Ireland. The criteria also includes updated house price indexation and gross disposable household income. The sustainable house prices are now higher in all regions except Northern Ireland. This has a positive impact on recovery rates and, consequently, Fitch's expected loss in UK RMBS transactions.

Fitch also reduced its foreclosure-frequency (FF) assumptions for loans in arrears based on a review of historical data from its rated UK RMBS portfolio. The changes better align the assumptions with observed performance in the expected case and incorporate a margin of safety at the 'Bsf' level.

**Interest-only Concentration:** The transaction has a material concentration of interest-only (IO) loans maturing within a three-year period during its lifetime, peaking at 50.4% between 2029 and 2031. Where a concentration is present, Fitch will derive an IO concentration's weighted average (WA) FF and in the analysis apply the higher of IO concentration WAFF and the standard portfolio WAFF for each rating level. For this pool, Fitch has applied the FF based on the IO concentration WAFF.

**Portfolio Loss Floor Activated:** Fitch's asset model applies a portfolio loss floor that is intended to ensure sufficient credit enhancement to mitigate the risk of idiosyncratic recovery outcomes within a portfolio that would otherwise have a small loss expectation. The portfolio loss floor is activated for Paragon 12.

**Stable Asset Performance:** Late stage arrears for Paragon 12's asset pool have remained low at 0.2%. 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 arrears reduction. Paragon's extensive use of its receiver of rent strategy has limited delinquencies across the Paragon series of transactions.

**Rating Cap for Junior Notes:** The only credit enhancement available to the junior notes is in the form of a first loss fund, which can either be invested in authorised investments or be held in the transaction account at Barclays Bank PLC (A+/Stable). As a result, these

notes are directly linked and capped at Barclays Bank plc's 'A+' Long-Term Issuer Default Rating (IDR).

## **RATING SENSITIVITIES**

### **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 economic performance is strongly correlated to increasing levels of delinquencies and defaults that could reduce credit enhancement available to the notes.

Fitch conducted sensitivity analyses by stressing the transaction base-case FF and recovery rate (RR) assumptions, and examining the rating implications on all classes of issued notes. A 15% increase in the WAFF and a 15% decrease in the WARR will result in downgrades of one notch for the class B notes and three notches for the class C notes.

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

Stable to improved asset performance driven by stable delinquencies and defaults would lead to increasing credit enhancement and, potentially, upgrades. A decrease in the WAFF of 15% and an increase in the WARR of 15% would imply an upgrade of two notches for the class C notes, if the notes are not capped at Barclays Bank's Long-Term IDR.

The class A and B notes' ratings are at the highest level on Fitch's scale and cannot be upgraded.

## **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 pool and the transaction. 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 pool ahead of the transaction's initial closing. The subsequent performance of the transaction 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 any 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 rating of the class C notes is linked to the IDR of Barclays Bank.

## **ESG CONSIDERATIONS**

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. 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**

[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 20 Sep 2021\)](#)

[Global Structured Finance Rating Criteria \(pub. 26 Oct 2021\) \(including rating assumption sensitivity\)](#)

[UK RMBS Rating Criteria \(pub. 23 May 2022\) \(including rating assumption sensitivity\)](#)

[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 15 Jul 2022\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 29 Jul 2022\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 01 Aug 2022\)](#)

**APPLICABLE MODELS**

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

Multi-Asset Cash Flow Model, v2.12.2 (1)

ResiGlobal Model: UK, v1.4.0 (1)

## ADDITIONAL DISCLOSURES

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## ENDORSEMENT STATUS

Paragon Mortgages (No. 12) Plc

UK Issued, EU Endorsed

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