

# Paragon Mortgages (No.23) PLC

## Presale

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### Capital Structure

Class	Expected Rating	Outlook	Amount	CE <sup>c</sup> (%)	Final Maturity	TT <sup>a</sup> (%)	TTLM <sup>b</sup>
A1	AAAsf	Stable	TBD(EURm)	11.76	Jan 43	TBD	TBD
A2	AAAsf	Stable	TBD(GBPm)	11.76	Jan 43	TBD	TBD
B	AAsf	Stable	TBD(GBPm)	7.01	Jan 43	4.75	4.11
C	A+sf	Stable	TBD(GBPm)	2.56	Jan 43	4.45	3.85
E	NR	n.a.	TBD(GBPm)	n.a.	Jan 43	2.50	2.16
<b>Total issuance</b>			<b>TBD(GBPm)</b>				

Expected ratings do not reflect final ratings and are based on the pool data provided by the issuer as of 1 June 2015 and the capital structure provided as of 18 June 2015. These expected ratings are contingent on final documents conforming to information already received and no deviation in the default and recovery levels of the final closing pool

<sup>a</sup> Tranche thickness percentage - ratio of class size to collateral balance

<sup>b</sup> Tranche thickness loss multiple - TT% divided by Fitch's base case loss expectation. See also **Structured Finance**

**Tranche Thickness Metrics**, 29 July 2011

<sup>c</sup> Credit enhancement – Includes initial loss portion of reserve fund. The actual credit enhancement could be different from that modelled and the final capital structure will be assessed before assigning final ratings

### Transaction Summary

Fitch Ratings has assigned expected ratings to the residential mortgage-backed notes to be issued by Paragon Mortgages (No.23) PLC (PM23), an SPV incorporated in England and Wales. Fitch expects the final pool of loans backing the notes after the six month pre-funding period to consist solely of prime buy-to-let (BTL) residential mortgages originated by Paragon Mortgages (2010) Limited (Paragon), a wholly owned company of Paragon Group plc. The mortgages are serviced by Paragon, with Homeloan Management Limited as back-up servicer.

### Key Rating Drivers

**Buy-to-Let Portfolio:** The portfolio consists entirely of BTL loans for which Fitch applies an increase to the frequency of foreclosure based on its criteria. This is because while BTL loans have performed well in the current environment, they performed worse than owner-occupied properties immediately following the last housing crisis.

**Higher LTV's:** Paragon changed its lending guidelines about a year ago to allow for loans up to 85% LTV (including fees), which is reflected in the larger portion of loans with an LTV over 80% (16.2%) compared with previous transactions. Nearly all the loans in this portfolio have been originated since March 2015.

**High London Concentration:** Within the portfolio 32.5% of the properties are located in Greater London. While this is typical for BTLpools, it is still much higher than the proportion of the UK population in this region. Fitch views properties in this region to be overvalued and applies a sustainable price discount of 31.1% in its stressed scenarios. In addition, the agency made an adjustment to the default probability for geographical concentration.

**Prime Underwriting, Strong Performance:** Fitch has given credit to Paragon's robust underwriting practices, supported by the strong historical performance, with low arrears and defaults outperforming the UK index.

**Liquidity Support:** The first loss fund represents 2.5% of the notes balance. Of this, a liquidity amount equal to 2.5% of the rated notes is available only to pay interest on classes A, B and C together with principal receipts in case of a shortfall. The remaining reserve can be used to cure losses.

### Related Presale Appendix

[Paragon Mortgages \(No.23\) PLC](#)

### Related Research

[Representations, Warranties, and Enforcement Mechanisms in Global Structured Finance Transactions \(June 2015\)](#)

[Structured Finance Tranche Thickness Metrics \(July 2011\)](#)

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Figure 1  
Transaction Comparison

	PM23 <sup>c</sup>	PM22	PM20	PM19	PM18
Closing date	July 2015 expected	March 2015	July 2014	March 2014	September 2013
<b>Total issuance (GBP)</b>	<b>TBD</b>	<b>300,009,117</b>	<b>350,000,000</b>	<b>350,000,000</b>	<b>273,000,000</b>
Preliminary credit enhancement (%)					
AAA	11.76	10.50	8.92	10.56	12.8
AA	7.01	6.50	2.06	6.06	7.1
A	2.56	2.50	n.a.	2.06	2.1
Initial reserve (% of initial balance)					
	2.5	2.5	3.0	3.0	3.0
Target after arrears/loss triggers					
	4.0	4.0	4.0	4.0	4.0
Liquidity					
	yes	yes	yes	yes	yes
<b>WAFF (%)</b>					
AAA	23.0	22.3	21.8	21.0	22.6
AA	18.6	17.9	17.6	17.0	18.4
A	13.7	13.3	13.1	13.1	14.1
BBB	9.3	8.9	8.9	9.2	9.9
<b>WALS (%)</b>					
AAA	71.1	69.8	67.1	69.9	70.2
AA	66.2	64.7	61.7	63.8	64.9
A	59.0	57.4	54.1	56.4	57.0
BBB	54.1	52.3	48.5	51.4	51.7
<b>WARR (%)</b>					
AAA	44.2	45.5	48.2	48.0	47.6
AA	49.1	50.6	53.6	53.1	52.9
A	54.0	55.7	59.0	58.1	58.3
BBB	59.0	60.8	64.4	63.1	63.7
<b>WAMVD (%)</b>					
AAA	65.4	64.7	64.5	64.5	61.9
AA	61.7	60.9	60.7	60.8	57.9
A	58.0	57.0	56.8	57.2	54.0
BBB	54.3	53.2	53.0	53.5	50.0
<b>Portfolio</b>					
Collateral balance (GBP)	130,816,463	244,234,504	320,847,097	321,681,614	272,981,182
Average current balance per borrower (GBP)	174,190	179,058	172,221	155,658	169,448
WA original valuation (GBP) <sup>a</sup>	225,896	225,115	212,763	198,353	204,478
Largest indexed valuation (GBP)	1,900,000	2,000,000	2,350,000	2,987,058	3,085,168
WA seasoning (months) <sup>a</sup>	1	2	18	32	4
GL/SE concentration (%) <sup>a</sup>	51.5	43.5	43.5	57.2	54.9
WA OLV (%) <sup>a</sup>	72.3	72.5	72.2	69.6	72.9
WACLTV (%) <sup>a</sup>	72.5	72.3	71.6	70.9	72.8
WACLTV (indexed values) (%) <sup>a</sup>	72.5	72.3	69.2	68.5	72.3
WAOLTV>80% (%) <sup>a</sup>	16.24	11.8	5.4	4.9	0.6
WAOLTV>90% (%) <sup>a</sup>	0.10	0.2	0.2	0.6	0.0
WA ICR (%) <sup>b</sup>	89.4	90.8	100.8	89.3	82.9
WA DTI (%)	n.a.	n.a.	n.a.	30.8	n.a.
WA stabilised margin (%)	4.7	4.7	4.7	4.1	4.7
Interest-only loans (%)	92.1	91.7	91.1	92.2	93.4
Buy-to-let (%)	100.0	100.0	100.0	97.9	100.0

<sup>a</sup> As calculated by Fitch

<sup>b</sup> As calculated by Paragon using Fitch's interest rate assumption of 4% plus the relevant margin. Note that the stress rate for previous deals was 5.5%

<sup>c</sup> Final pool characteristics as expected at the end of the prefunding period

Source: Fitch and pool cuts provided by Paragon

**Related Criteria**

[EMEA RMBS Master Rating Criteria \(March 2015\)](#)

[EMEA Residential Mortgage Loss Criteria \(March 2015\)](#)

[EMEA RMBS Cash Flow Analysis Criteria \(March 2015\)](#)

[EMEA Criteria Addendum: UK - Residential Mortgage Loss and Cash Flow Assumptions \(June 2015\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds \(May 2014\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum \(May 2014\)](#)

[Criteria for Servicing Continuity Risk in Structured Finance \(July 2014\)](#)

Figure 2

**Key Transaction Parties**

<b>Issuer</b>	Paragon Mortgages (No.23) plc
<b>Originator</b>	Paragon Mortgages (2010) Limited (PML)
<b>Seller</b>	Paragon Mortgages (2010) Limited
<b>Servicer</b>	Paragon Finance PLC
<b>Back-up servicer</b>	Homeloan Management Limited (RPS2+)
<b>Administrator</b>	Paragon Mortgages (2010) Limited
<b>Trustee</b>	Citicorp Trustee Company Limited
<b>Subordinated lender</b>	Paragon Finance PLC
<b>Transaction account bank<sup>a</sup></b>	Citibank N.A., London Branch (A+/Stable/F1)
<b>Collection accounts</b>	Barclays Bank plc (A/Stable/F1)
<b>Principal paying agent<sup>a</sup></b>	Citibank, N.A., London Branch
<b>Swap providers</b>	Basis swap providers: Macquarie Bank Limited (A/Stable/F1) and Lloyds Bank plc (A+/Stable/F1) Currency swap provider: Lloyds Bank plc
<b>Arrangers</b>	Lloyds Bank plc, Macquarie Bank Limited, London Branch
<b>Joint lead managers</b>	Lloyds Bank plc, Macquarie Bank Limited, London Branch, Morgan Stanley & Co. International plc and Natixis

<sup>a</sup> Rating is for the head office.  
Source: Transaction documents

**Key Differences from Previous Paragon Transactions**

The underlying assets have similar characteristics to those of previous Paragon transactions and all loans were originated by Paragon Mortgages (2010) Limited (PML) through its ordinary course of business. Similar to Paragon Mortgages (No.22) PLC, the PM23 series includes a mortgage conversion mechanism that allows the seller to keep a loan in the transaction when the borrower undergoes a product switch at the end of their teaser rate whereby any interest rate differential is cash-collateralised by Paragon subject to certain conditions (see *Mortgage Conversion*). There are currently four loans in this portfolio which underwent a product conversion in previous securitisations which were repurchased by PML.

**Model, Criteria Application and Data Adequacy**

Fitch analyses the collateral for UK residential transactions using a country-specific, loan-by-loan mortgage default model. The model subjects the mortgage loans to stresses based on Fitch’s assessment of historical house price movements and mortgage defaults in the UK. The agency’s study showed that a borrower’s LTV, reflecting the size of their down-payment and their willingness to pay, and a borrower’s debt-to-income (DTI) ratio or income multiple, reflecting their ability to pay, to be the key determinants of default probability in the UK.

Paragon provided Fitch with a loan-by-loan data template, cumulative loan book losses and 90+ dynamic arrears data. In addition, Paragon has provided Fitch loan-by-loan arrears history on all originations of PML since 2010 and 90+ static cumulative arrears on its loan book. Fitch considers that the data available for the analysis is of good quality and factors in the strong performance observed compared to peers into its analysis.

A preliminary Agreed Upon Procedures report (AUP) from an internationally recognised auditing firm verifying data accuracy has been provided to Fitch. Overall, the loan attributes checked and the size of the pool sample were in line with market standards. There were no findings which were of concern for the transaction.

The collateral review of the mortgage portfolio also involves reviewing loan-by-loan loss severity information on the originator’s sold repossessions, during which the agency determines the originator’s experienced loss severity rate and quick-sale adjustment (QSA). The QSA, calculated using the repossession data provided by the originator, was about 32.5% for Paragon repossessed and sold properties. As the QSA figures are higher than Fitch’s criteria assumption of about 30%, Fitch has increased the QSA assumptions to 32.5%.

To determine the levels of credit enhancement needed to support the ratings, Fitch simulated the transaction’s cash flows using a model incorporating its cash flow stresses.

## Asset Analysis

### Lender Adjustment

Fitch's base default probabilities assume that origination, underwriting and servicing practices and procedures are in line with those of a standard traditional UK mortgage lender with market expertise, financial stability and relevant management experience.

As part of the analysis, Fitch performed an on-site operational review to assess, among other things, the lender's origination practices and its servicing capabilities. The importance of the role both of these have in the transaction is recognised in terms of the underlying loan portfolio performance.

As a mortgage company, Paragon specialises in the origination of BTL products through intermediaries, and since February 2001 a large proportion of originations have been to professional BTL investors. To qualify for the benefits of such a loan a borrower must already possess a portfolio of at least three properties and must present a minimum of two years financial accounts for the underwriters to scrutinise. Such professional BTL investors are typically characterised as individuals who earn a substantial portion of their income from the rental yield on their portfolio. Indeed, some may rely entirely on this source of income for their livelihood.

For new originations, the rental income from single, self-contained properties must be a minimum of 125% of the mortgage payment calculated on an interest-only basis, at either the product rate, or a reference rate of 5%, whichever is the higher. The rental income for all other property types must be a minimum rental income of 130% of the mortgage payment calculated on an interest-only basis, at either the product rate, or the reference rate of 7%, whichever is the higher.

Fitch has considered several strengths and concerns in its lender adjustment (see also *Appendix A - Origination, Underwriting and Servicing*).

Among others, the main concern is that due to the manual process used to underwrite the mortgages if the number of applications were to rise sharply then the quality of the underwriting could suffer as a consequence of the increased workload.

In Fitch's view, strengths to consider are: (1) all applications are manually underwritten and require income verification in addition to using stressed minimum rental values; (2) all mortgage applications require a full valuation, with a sense check of valuations using comparable data; (3) structured mandate levels are in place for loan approvals.

It is also important to note that, given the current state of the mortgage market, it is difficult for buyers to secure mortgages due to tighter lending criteria and limited product availability. This has, and quite possibly will for the foreseeable future, caused borrowers to remain in their current rental agreement(s) thus increasing the demand for rental properties and leading to an increase in rents paid to landlords. This will, and has, caused an increase in revenues for professional landlords and reduced the arrears rates in BTL securitisations. Potential interest rate rises will be the biggest single risk factor.

Fitch has applied a positive underwriting adjustment on the basis of the robust origination and underwriting practices observed and the long track record of good historical performance data outperforming the average UK index.

### Buy-To-Let

The entire pool consists of recently originated prime BTL loans. Fitch considers loans on BTL properties to be inherently more susceptible to default than those secured on an owner-occupied property because:

- the property is not the borrower's prime residence and so the borrower may be more likely

to default on the loan during a time of financial stress;

- the servicing of the loan is primarily dependent on rental income, which may be more volatile in stress periods than personal income.

In addition, landlord borrowers may target particular regions or groups of tenants within their portfolios, which may lead to a concentration of similar properties in a similar location at the individual borrower level.

One important mitigating feature of BTL loans is that, upon default, the foreclosure process is quicker than for owner-occupied properties, as tenants with short-hold tenancy agreements can generally be more easily evicted than owner-occupiers, while the repossession process through the courts is shorter.

In addition, Fitch has noted that a high proportion of the borrowers in this pool are professional landlords, with a minimum of 12 months' experience of managing at least three properties and with a recognised aptitude for enforcing tenancy contracts. The remaining BTL borrowers are private investor landlords, also with significant experience who aim to stay in the market long term.

Professional landlords tend to be more adept at managing a portfolio of properties, monitoring and acting on economic conditions and market indicators, reducing downtimes between tenancies, and selecting tenant types and target locations than standard borrowers. This is based on the time and energy that professional landlords are able to spend administering their portfolio and researching the market.

For BTL properties a receiver of rent process (ROR) can be used to manage repossessed properties. Following the appointment, the ROR will directly collect rent from paying tenants and pass it to the lender to pay down any arrears. This helps maintain the rental income stream and would thus keep a steady flow of cash to the transaction.

### **Interest-Only Loans**

92.05% of the loans in the preliminary pool are interest only, which is typically the loan vehicle favoured by BTL borrowers. Interest-only loans can be construed to be riskier than amortising loans because of the greater risk that the borrower may be unable to repay the debt in full at maturity (ie balloon payment risk). However, interest-only hits will ordinarily not apply to BTL products as the BTL market is almost entirely interest-only which is factored into the general BTL product adjustments. The risk in this transaction is further mitigated by the fact that the borrowers are predominantly professional landlords with a demonstrated ability to manage a property with an interest-only loan, and by the strong performance on previous Paragon transactions. In light of the mitigants above no adjustment has been made to interest-only loans in this pool.

### **Concentration Risk**

The small initial portfolio size at closing could potentially lead to two levels of concentration risk in this transaction. The first emanates at the loan level where any single loan could potentially cause disproportionately larger losses than would be the case in a larger more diversified pool. The second relates to Paragon's business model of targeting professional landlords who typically have a number of BTL loans with Paragon. Hence if one landlord has a number of loans in the pool, each one not large in itself, the total exposure could become significant. There was no excessive concentration risk for this portfolio and no further adjustments were made.

### **Receiver of Rent (ROR)**

Fitch believes the risk of exposure to a single loan or borrower is mitigated to a large extent by Paragon's reliance on the ROR process. If Paragon believes a borrower is struggling it will



appoint an ROR for the entire portfolio of the borrower, which does not require court approval. They will send a surveyor with a property agent to the property and inform the tenant that they have to send their rent to the ROR, who forwards it on to Paragon, instead of paying the landlord. No monies from that point onwards are allowed to be passed on to the borrower. Any payments received in excess of monthly mortgage payments are used to prepay the loans. Where the property is vacant a decision is made to rent or sell the property and a locksmith will also change the locks to the property.

This is a process Paragon initiates early on (typically within two months) as part of its approach to monitoring and managing arrears. Paragon holds discussions with borrowers, who have been identified as struggling to keep up with payments, regarding their current financial situation and then assess their ability to continue managing the property effectively.

Even if a borrower becomes current at a later date, Paragon is not obliged to release the property back to the borrower, which could effectively force a borrower to redeem all the mortgages with Paragon.

### **Self-Employed Borrowers**

Self-employed borrowers make up 45.73% of the preliminary pool. These are typically professional landlords who rely solely on rental income for their earnings. Given the demonstrated ability of professional landlords to manage a property (based on the previous performance of Paragon transactions) no adjustment was made for borrowers designated as self-employed in this pool.

### **Illiquid Properties**

11.34% of the loans fall into Fitch's jumbo and small categories, which represent property values at the less liquid ends of the property market.

Historical portfolio performance in most countries typically shows that high-value and low-value properties tend to realise higher than average relative losses, even in times of low stress in the housing market.

Where a property value is classified as high or low, Fitch will reduce the distressed property value after deduction of the MVD by an incremental illiquidity adjustment factor. These illiquidity adjustment factors are derived by rating scenario, with a larger haircut applied to the distressed property value (i.e. after indexation and MVD) in more stressed scenarios.

### **Quick Sale Adjustment**

The Market Value Decline (MVD), which reflects Fitch's view of each region's vulnerability to house price declines, and reflects historical experience and socioeconomic factors, also incorporates a QSA. This is the discount a seller is likely to have to suffer for selling a property in a depressed market; often reflecting non-marketable conditions. Professional landlords also tend to modify properties in order to maximise rental yields which can affect the market value of the properties, or use additional revenue to undo the modifications, when it comes to a sale. The QSA is the same across all regions and rating scenarios.

The QSA calculated using the repossession data provided by Paragon, was about 32.5%. As the QSA figures were higher than Fitch's criteria assumptions, the agency has increased the assumptions for the QSA for PM23.

### **Geographical Concentration**

The mortgage portfolio is skewed towards Greater London, where Fitch expects about 13.04% of the properties in the mortgage portfolio to be located.

The percentage of loans in Greater London in this portfolio is 32.52%, considerably higher than the proportion of the UK population in this region. As a result of the geographical concentration,

Fitch has made an upward adjustment to the default probability.

### Default Model Output

The following table illustrates the asset analysis results across different rating scenarios. Fitch has used these WAFF and WARR levels when modelling the transaction cash flows.

Figure 3

#### Fitch Default Model Output (Preliminary Pool)

Rating level (%)	WAFF <sup>a</sup>	WARR <sup>b</sup>	MVD <sup>c</sup>
AAA	23.02	44.16	65.45
AA	18.56	49.10	61.72
A	13.73	54.05	58.00
BBB	9.28	58.99	54.28

<sup>a</sup> Weighted-average foreclosure frequency

<sup>b</sup> Weighted-average recovery rate

<sup>c</sup> Market value decline

Source: Fitch

## Financial Structure and Cash Flow Modelling

### Credit Enhancement

#### Subordination

The class B, C and E notes will be sized at 4.75%, 4.45% and 2.5%, of the mortgage portfolio respectively, and will provide credit enhancement to the class A note. Any principal losses resulting from the mortgage portfolio will be recorded on the PDL which will be paid in such a way that the amount corresponding to the Class A notes will be paid first before the amount corresponding to the class B, C and D notes.

#### First Loss Fund

To provide limited coverage for any interest shortfalls and principal losses, the issuer will establish at closing, a non-amortising first loss fund to the amount of 2.5% of the GBP equivalent of the initial total note balance. This can step up to 4% of the GBP equivalent initial total note balance if 60+ days arrears exceed 3% of the outstanding note balance or cumulative losses exceed 2%.

A portion of this first loss fund will be held aside for liquidity. This liquidity amount is sized at 2.5% of the outstanding rated notes, and can be used to pay interest on classes A, B, and C. Therefore only 2.5% (or 0.06% of the total GBP equivalent note balance) of the first loss fund is available as credit enhancement at close. The liquidity amount declines in line with the rated notes, and as such, the excess funds available for credit enhancement are designed to increase as the rated notes amortise. Principal receipts can be used to top up the First Loss Fund.

In addition, the liquidity amount has triggers such that as the PDL increases above 50% for the relevant note class, the liquidity amount is no longer available to pay interest on that class of note. This PDL trigger does not apply to the class A notes. As a result, the excess amount of the first loss fund over the liquidity amount – that is available to use as credit enhancement – increases as these triggers are breached. Only this excess amount over the liquidity amount has been taken into account in the calculation of credit enhancement.

#### Excess Spread

Excess spread is also a source of credit support and liquidity for all tranches of notes, with the advantage of being a potentially ongoing resource. However, unlike “hard” cash collateral, excess spread is dependent on the performance of the pool, and as such is often least available when most needed. It is eroded by delinquencies and defaulted loans, which is compounded if higher margin loans are affected. Should high-margin loans amortise more quickly than those with lower margins (whether as a consequence of divergent prepayment rates or shorter tenures), then there is further compression of excess spread.

To the extent available, excess spread, after meeting certain items of the waterfall, will be available to replenish any debit balances that arise on the PDLs.

### **Principal to Pay Interest**

If there is a shortfall in revenue funds to pay senior fees and interest on the class A, B and C notes, funds may be reallocated from principal receipts to cover the shortfall. The principal made available to cover these revenue deficits will be recorded on the PDL and is to be recouped from future revenue. Principal funds can only be used in this manner if the relevant class of notes does not have a PDL exceeding 50% of the note balance.

### **Minimum Mortgage Rate**

The administrator must ensure that the WA margin applicable to the mortgages after taking into account all hedging arrangements, income received from the investment of funds in the transaction account, and income from early repayment charges and scheduled releases from the margin reserve fund, is not less than three-month sterling Libor plus 4.0% until October 2020 and three-month sterling Libor plus 4.5% thereafter. Should the WA margin fall below these levels, the mortgage administrator will be obliged to either:

- increase the rates on variable-rate loans in the pool, to ensure sufficient revenue funds are available; or
- make a drawing on the subordinated loan, such that the required levels are met.

Fitch does not give credit to this kind of arrangement since there is no guarantee that in a low interest-rate environment the administrator would be able to maintain a higher mortgage rate than that the borrower could get if it decided to refinance elsewhere.

### **Mortgage Conversion**

Paragon has included a Mortgage Conversion feature. Initially, when a borrower opted for a product switch at the end of their teaser period, Paragon had to repurchase such receivable according to the conditions under the transaction documentation. This new interest rate conversion feature enables Paragon to keep the loan in the portfolio and cash-collateralise the difference in mortgage collections due to a product switch to a lower interest rate. A conversion is subject to, among others, the following conditions:

- the borrower is not in arrears;
- the conversions are capped at 10% of the current balance at closing and the current balances of the loans sold as part of the pre-funding; and
- the margin reserve fund has been credited with the amount equal to the interest rate differential on the mortgage loan after the switch.

In addition, Paragon can convert interest-only loans into a repayment type loan (but not any other product type) up to 10% of the current balance at closing and the current balances of the loans sold as part of the pre-funding. This is referred to as a Repayment Conversion.

As Paragon is cash-collateralising any decrease in interest rate from an interest rate conversion and any product conversion to a fixed rate mortgage will be hedged in the transaction, Fitch believes that this additional feature has no impact on the credit analysis.

### **Margin Reserve Fund**

A margin reserve fund, fully funded at closing, has been established to bring the interest payments on the loans to Libor plus 3.0% for the first two years and Libor plus 4.50% thereafter. The fund also acts to mitigate the cost of carry during the pre-funding period and also the cost of carry generated by the further advance pre-funding reserve. The funds will be released into the revenue waterfall according to a pre-determined schedule.



### Further Advance Pre-Funding Reserve

A further advance pre-funding reserve, fully funded at closing, up to GBP1,500,000 will be established to purchase any discretionary further advances up to any principal determination date, prior to the call option date, designated by PML (as administrator). Any funds remaining in the reserve on any principal determination date prior to the call option date will be released into the principal waterfall.

### Early Amortisation Events: Events of Default

The following will constitute an event of default (EoD):

1. non-payment by the issuer of principal in respect of the notes within seven days following the due date;
2. non-payment by the Issuer of any interest amount on the notes within 15 days following the due date;
3. breach of contractual obligations by the Issuer under the relevant documents which is materially prejudicial to the interests of the holders of the most senior class of notes; or
4. an issuer insolvency event which is materially prejudicial to the interests of the holders of the most senior class of notes.

### Hedging

#### *Interest-Rate Risk*

Payments to be received by the issuer under the loans are subject to variable and fixed rates of interest.

#### *Fixed Rate-to-Three Month Pound Sterling Libor (Hedged)*

The issuer will enter into a series of interest-rate swaps to address the possible variation between three-month sterling Libor and the rate of interest earned on the fixed loans. This hedging is based on a scheduled step-down balance in line with the fixed-rate mortgages' amortisation schedule.

The swap is subject to default and prepayment risk. If a borrower were to default on its mortgage, Paragon would remain liable to pay the fixed swap rate under the agreement. Under the administration agreement, Paragon will have the option to terminate the swap in case the aggregate principal amount received from borrowers in respect of the fixed rate mortgage exceeds GBP10m, subject to certain conditions such as, among others, no termination fee payable for the issuer. The rising interest rate environment is the driving scenario in this transaction, which would, together with the option to terminate the swap, mitigate the risk of the issuer incurring any loss under the swap.

#### *Currency Risk Hedged*

The issuer will enter into a balance-guaranteed cross-currency swap to hedge the sterling interest and principal amounts received from the borrowers on the mortgage loans for the euro-based interest and principal payable on the class A1 notes.

If the cross-currency swap is terminated, principal amounts payable to the class A1 and A2 notes would remain the same as if the cross-currency swap had not been terminated. However, due to the lack of the original cross-currency swap, the amounts received in euros may be higher or lower than that which would have been received under the original cross-currency swap for the A1 notes.

To the extent the amount received is higher, any such excess amount will be put into a swap termination reserve account. To the extent amounts received are lower, such shortfalls will, to the extent possible, be covered by amounts standing to the swap termination reserve account.

This mechanism ensures that the currency exchange-rate risk is fully borne by the class A1 notes and protects the class A2, B, C and E notes from such risk.

Therefore in the event that the cross-currency swap is terminated, there is a risk that the A1 notes will not receive its full principal amount outstanding due to currency mismatches. However, the likelihood of this happening is mitigated by the fact that the cross-currency swap provider is subject to the counterparty triggers detailed in the section *Counterparty Risk*.

### Scenario Testing

The capital structure has been stressed in Fitch’s rating analysis under certain scenarios, including: high and low CPR scenarios; increasing and decreasing interest-rate scenarios; and front and back loaded default curve scenarios.

The stressed scenarios result in no principal losses and the timely payment of interest for each note under each rating category. The most stressful scenarios in the cash flow stress tests are those with an increasing interest rate, high prepayment, and a back-loaded default curve.

Some Paragon transactions have had a high conditional prepayment rate (CPR), above Fitch’s typical high CPR stress (see *Performance Analytics* below). Fitch has therefore included an additional stress in its high prepayment assumption in all rating scenarios. In a ‘AAAsf’ rating scenario Fitch has assumed a CPR of 30% for years 3, 4 and 5 of the transaction, rather than the standard 25% in the ‘AAAsf’ scenario.

### Expected Rating Sensitivity<sup>1</sup>

Unanticipated increases in the frequency of defaults and loss severity on defaulted receivables could produce loss levels higher than Fitch’s base case, and would be likely to result in a decline in credit enhancement (CE) and remaining loss-coverage levels available to the notes. Decreased CE may make certain note ratings susceptible to potential negative rating actions, depending on the extent of the decline in coverage. Hence, Fitch conducts sensitivity analysis by stressing a transaction’s initial base case assumptions.

This section of the report provides a greater insight into the model-implied sensitivities the transaction faces when one assumption – WAFF and/or WARR – is stressed, while holding others equal. The modelling process uses the estimation and stress of default and loss assumptions to reflect asset performance in a stressed environment. The results below should only be considered as one potential outcome, given that the transaction is exposed to multiple risk factors that are all dynamic variables.

#### Expected Rating Sensitivity to Defaults

	Class A	Class B	Class C
Original rating	AAAsf	AAsf	A+sf
15% increase in default rates	AA+sf	AA-sf	Asf
30% increase in default rates	AAsf	A+sf	Asf

Source: Fitch

#### Expected Rating Sensitivity to Recovery Rates

	Class A	Class B	Class C
Original rating	AAAsf	AAsf	A+sf
15% decrease in recovery rates	AA+sf	AA-sf	A+sf
30% decrease in recovery rates	AA+sf	AA-sf	Asf

Source: Fitch

<sup>1</sup> These sensitivities only describe the model-implied impact of a change in the input variables. This is designed to provide information about the sensitivity of the rating to model assumptions. It should not be used as an indicator of possible future performance

### Expected Rating Sensitivity to Shifts in Multiple Factors

	Class A	Class B	Class C
Original rating	AAAsf	AAsf	A+sf
15% increase in default rates, 15% decrease in recovery rates	AAsf	A+sf	Asf
30% increase in default rates, 30% decrease in recovery rates	AA-sf	Asf	BBB+sf

Source: Fitch

### Counterparty Risk

Fitch performed an on-site operational review of Paragon in May 2015 to assess, among other things, the lender's origination, underwriting and servicing capabilities (see *Appendix A*).

Review visits do not constitute 'due diligence' and Fitch does not perform due diligence but relies upon the accuracy of data given to it.

### Servicer

Paragon, as administrator for the PML pool, have delegated its responsibilities to Paragon Finance (PFPLC), which is responsible for administering the mortgage loans in the portfolio.

At the group's West Midlands headquarters, ongoing contact with borrowers is maintained via a telephone-based debt management system known as CACS. CACS enables collection agents to schedule calls to borrowers upon a missed payment and provides a detailed, diary-based collections management platform. This site has substantial operational history, and Fitch considers PFPLC to be more than adequate in its role as servicer. HML has been designated substitute administrator.

### Hedge Providers

#### *Interest-Rate and Cross-Currency Swap*

At closing, the issuer will enter into a series of interest-rate swaps to eliminate the risk between the fixed rate mortgages and note Libor. This hedging is based on a scheduled step-down balance. At closing the issuer will also enter into a cross-currency swap to hedge the currency mismatches between the sterling-denominated assets and the euro note liabilities. This hedging is balance guaranteed. The counterparties for the interest-rate swap are Macquarie Bank Limited, rated 'A'/Stable/'F1' and Lloyds Bank plc rated 'A+'/Stable/'F1', whereas Lloyds Bank plc is also the provider of the cross-currency swap. The swap providers satisfy Fitch's expected minimum rating for swap counterparties (detailed in the report *Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum*, published 14 May 2014).

Upon a downgrade of the swap providers below Long-Term 'A' or 'F1', one of the following remedial measures must be applied by the swap counterparty:

1. arrangement for a third-party guarantor with the requisite rating;
2. transfer of the swap to a counterparty with the requisite rating;
3. posting of the required collateral to cover the potential loss upon its default; or
4. take such other action as will result in the rating of the notes being maintained or restored.

Only actions (1) and (2) are available upon a downgrade below investment grade. Where collateral is a feasible mitigant — for example, where the swap provider is rated at least investment grade — posting is expected to be effected within 14 calendar days upon the downgrade of the counterparty below 'A' or 'F1'. Where collateral cannot be used as a mitigant, remedial action is expected to be taken within 30 calendar days upon the downgrade of the counterparty.

The swap documents include a clause that allows other unspecified actions, in addition to specific remedial actions, upon the breach of certain thresholds. This clause states that there could be alternative remedies that might be pursued so that a rating downgrade would not

occur. Fitch does not consider this clause to have any credit quality effect. The agency will always expect compliance with the provisions of its counterparty criteria upon rating threshold triggers being breached. If remedies as specified in the counterparty criteria are not pursued within specified timeframes, Fitch will analyse the impact of this non-compliance in its rating opinion, and a rating action could follow.

**Commingling Risk**

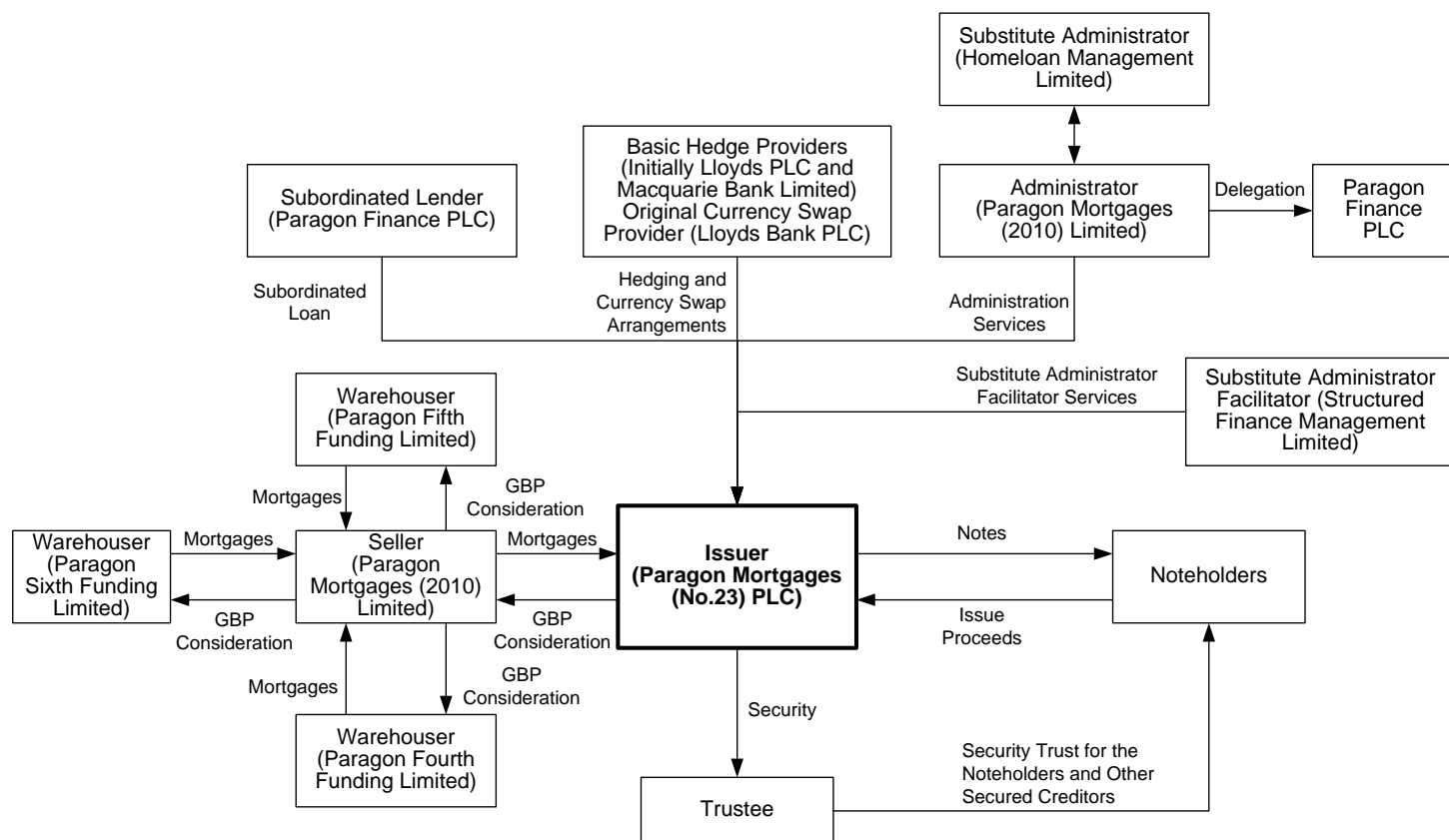
*Collections Account and Account Bank*

Borrower payments on PML mortgages are transferred from the servicer’s collection account (at Barclays Bank plc) to the transaction account (at Citibank N.A., London Branch) within one business day.

The transaction documentation states that should the short-term IDR of the collection account provider fall below ‘F2’, or its long-term IDR fall below ‘BBB+’, the collection account must be transferred to an eligible counterparty. Paragon has confirmed that borrower notification is not required to affect a redirection of direct debit payments. However, borrower payments are clustered at the end of the month and Fitch has assumed the loss of one month’s worth of scheduled interest to account for this concentration. Thus, in combination with the daily cash sweep, this framework complies with Fitch’s reduced exposure criteria on commingling risk (see *Counterparty Criteria for Structured Finance and Covered Bonds* and available at [www.fitchratings.com](http://www.fitchratings.com)).

Under the transaction documents, Paragon, as the transaction administrator, is required to undertake the replacement of counterparties including the issuer account bank, qualified investments, collection account bank and derivative counterparty if the counterparties cease to fulfil criteria defined in the transaction documentation. The criteria defined in transaction

Figure 4  
**Structure Diagram**



Source: Transaction documents

documentation relate both to specific minimum ratings (eg 'A'/F1', which are consistent with Fitch's counterparty criteria where the highest rated note is 'AAAsf') and to Fitch's current and future counterparty criteria. This mechanism deviates from Fitch's criteria, as Fitch generally expects transaction documentation to have self-sustaining provisions rather than reference rating criteria reports which are not drafted as legal documents.

However, Fitch does not expect this mechanism to negatively affect note ratings so long as the administrator maintains counterparties that are consistent with Fitch's counterparty criteria.

## Transaction and Legal Structure

### Legal Framework

On or about the closing date, the seller will assign the rights, title and interest in and to the mortgages to PM23 (a public company incorporated under the laws of England and Wales). There will be no recourse to the seller (except regarding loans sold in breach of warranty) so that the transfer to PM23 is treated as a true sale.

At closing, PM23 will enter into a deed of charge, creating security over its assets in favour of the trustee as security for all payments under the notes. The security will include first-ranking sub-mortgages and first-ranking fixed charges in favour of the trustee over all the issuer's rights, claims, title, benefit and interest in and to the underlying collateral.

The transaction structure is designed to ensure that seller insolvency would not interrupt the timely payment of principal and interest on the notes to investors. The seller will assign their rights, title and interest in and to the mortgages to the issuer. There will be no recourse to Paragon as the seller of the mortgages; the transfers are treated as a true sale.

The transaction has a pre-funding period in which Paragon may sell further loans to PM23, subject to certain conditions, including:

- a certificate of a director of Paragon confirms that the additional mortgages were originated in accordance with the Paragon Mortgages (2010) Limited lending guidelines;
- no enforcement notice has been served on the issuer; and
- no event of default of the notes has occurred;

### Representations and Warranties

The seller Paragon Mortgages (2010) Limited is a standalone vehicle, and therefore has limited resources to repurchase any mortgage receivables that breach the R&Ws given to the issuer. Fitch conduct further checks on the quality of the originations and performance data to assess the risk of R&W breaches in RMBS backed by mortgage loans where the seller and provider of R&Ws is rated below investment grade, not rated by Fitch, or an SPV with limited capital. These checks include the following:

#### *Loan File Reviews*

During the previous 12 month period on a site visit to Paragon's offices Fitch conducted an extended file review to check the quality of Paragon's originations on a larger number of loans (25 loans) than would typically be assessed during a review of an established prime lender. No material issues were found.

#### *Preliminary Pool Audit*

Fitch has received a preliminary Agreed Upon Procedures (AUP) report on a sample of the pool reviewed by an internationally recognised accounting firm before the transaction closes. The report had only a limited amount of findings and no further adjustment was made based on the results.



### *Historical Experience*

Paragon has a long history of originating mortgage loans, dating back to the late 1990s, and was able to confirm that it has only suffered one breach to date despite selling or securitising the majority of its originations to date. Paragon gave full R&Ws on the loans in those transactions in line with that for this transaction.

The mortgage sale agreement contains representations and warranties (R&Ws) given by the seller in relation to the pool of mortgages. No search of title has been conducted by the issuer or the trustee; rather they have relied on the R&Ws. If there is an irremediable breach of any of the R&Ws, the seller will be required to repurchase the loan(s) in question.

Specifically, the representations and warranties include the following.

- Each mortgage is secured on a freehold or leasehold residential, or mixed commercial/residential property situated in England or Wales.
- No lien or right of set-off exists between the mortgagee and any borrower.
- No mortgage is or will be repayable later than 31 December 2040.
- No obligation to make a further advance if a borrower is in breach of mortgage conditions.
- At the relevant purchase date, the maximum aggregate principal amount of all arrears on mortgages that may be purchased by the issuer is GBP1m.

### **Further Advances**

Discretionary further advances may be agreed and advanced to borrowers in the pool by, and at the discretion of, the administrator (acting on behalf of the issuer) using principal receipts or recoveries, provided that, among others:

- there was no debit balance on the principal deficiency ledger (PDL) as at the previous interest payment date;
- the reserve fund is at its required amount;
- the WA current LTV of the portfolio would not increase in value by more than 1% as a result of making the discretionary further advance after utilising the pre-funding;
- arrears over three months do not exceed 2% of the then-outstanding balance of the pool;
- the aggregate current balance of the 20 largest borrowers does not exceed GBP25m; and
- minimum interest rate for discretionary further advances is three-month sterling Libor plus 4.50%.

All further advances are capped at 8% of the GBP equivalent of the initial note balance.

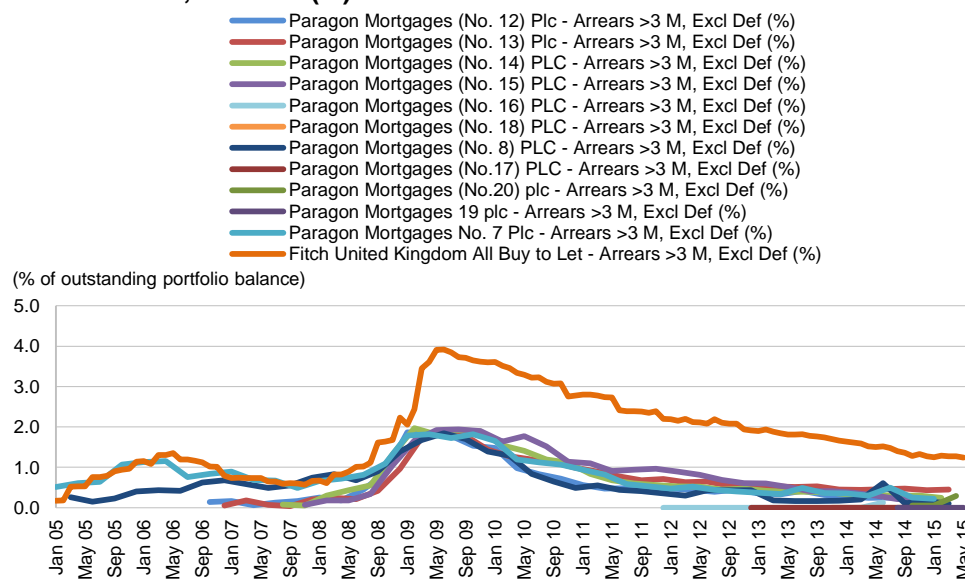
### **Disclaimer**

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## Performance Analytics

Figure 5

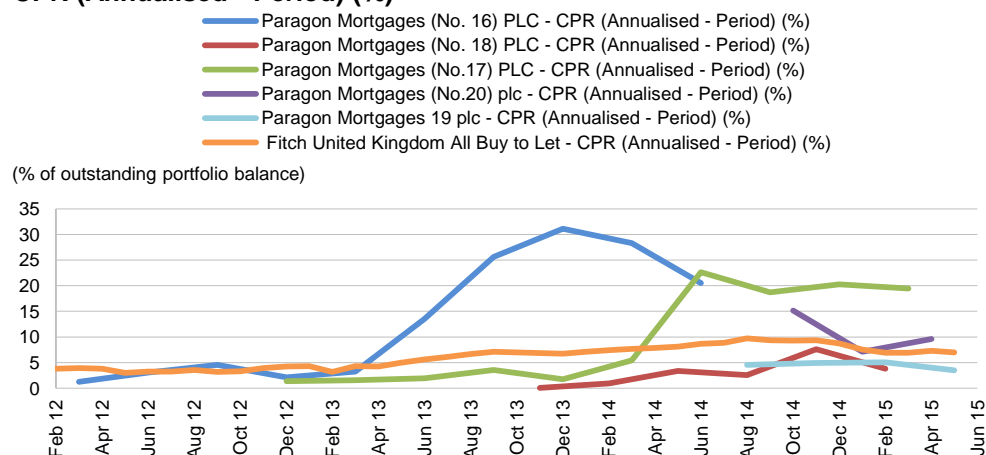
### Arrears > 3 M, Excl Def (%)



Source: Fitch, Investor reports

Figure 6

### CPR (Annualised - Period) (%)



Source: Fitch, Investor reports

The performance of transactions in the Paragon series remains comparable with one another, with each performing well, and better than most other UK BTL transactions. At end-March 2015 the percentage of loans in arrears by three months or more ranged between 0% and 0.46% (Paragon 13) of their respective outstanding collateral balances. Paragon's extensive use of ROR policies has contributed to the relatively low level of arrears across the series.

Prepayment rates spiked for PM16 in 2013 (see Figure 6). These prepayments are largely driven by a specific feature of Paragon loans originated immediately after the global financial crisis, which included a mandatory switch from interest-only to repayment after predetermined period (typically five years). As BTL is largely an interest-only market, this creates an incentive for borrowers to refinance.

## Appendix A: Origination, Underwriting and Servicing

### Origination

Paragon Mortgages Limited (PML) is a subsidiary of the Paragon Group, which specialises in the provision of various financial products to consumers. As a mortgage company, PML specialises in the origination of BTL products through intermediaries, and since February 2001 the vast majority of originations have been to professional borrowers. Since September 2010, a new originator, Paragon Mortgages (2010) Paragon's definition of a professional landlord is somebody who owns at least three BTL properties or has greater than 12 months experience with a BTL property.

Such professional borrowers are typically characterised as individuals who earn a substantial portion of their income from the rental yield on their portfolio; indeed, some may rely entirely on this source of income for their livelihood.

For new originations, the rental income from single, self-contained properties must be a minimum of 125% of the mortgage payment calculated on an interest only basis, at either the product rate, or a reference rate of 5%, whichever is the higher. The rental income for all other property types must be a minimum rental income of 130% of the mortgage payment calculated on an interest only basis, at either the product rate, or the reference rate of 7%, whichever is the higher.

PML has six levels of underwriting based on a hierarchy of mandates. To increase borrowings above these levels it may request additional information, such as a business plan or performance data or conduct an interview with the applicant. Large exposures, ie in excess of GBP2m, to single borrowers are monitored via a regular review of accounts, letting conditions, voids, demand, cash flows, as well as a consideration of the borrower's strategy for the next 12 months. These controls are designed to ensure PML is kept abreast of the performance of key borrowers' portfolios, and may mitigate against single obligor concentration within the reference portfolio.

Distribution is predominantly through the intermediary network with the balance of business coming via direct applications. The intermediary network comprises independent financial advisors and brokers. Paragon maintains the network by using a dedicated sales force that is organised by geographic area.

As with other BTL lenders, PML prefers to retain manual discretion in its lending procedures rather than adhere to a pro forma approach. As such, a hierarchy of mandates adhering to guidelines and criteria is in place to ensure that accountability is maintained. At the heart of policy-making is the overarching credit committee - comprising four standing members and other experts, that are called upon as appropriate, - which convenes on a monthly basis and presides over any changes to criteria and special cases.

Professional landlords are believed to be more adept at managing a portfolio of properties, monitoring and acting on economic conditions and market indicators, reducing downtimes between tenancies, and selecting tenant types and target locations than standard borrowers. This assertion is based on the time and energy that professional landlords are able to spend administering their portfolio and researching the market.

### Underwriting

PML has its own dedicated underwriting team where the underwriters are usually recruited from within the business, and receive one-on-one on-the-job training. If the underwriters are new to the business, it is expected they may take six months training prior to receiving a lending mandate. Monthly sample checks are completed against all underwriters by line management and further random checks are undertaken immediately after completion of a loan. Other control mechanisms are in place on the systems to ensure mandates and lending thresholds are not over-ridden.

All applications are input into Paragon's processing system by the introducer. During this process the automated decisioning system undertakes an initial assessment and issues a score before the case is reviewed by an underwriter. The score given dictates the level of further information required in order to fully underwrite the application if it is accepted. An underwriter will request the relevant information and log the action on the system. All actions logged on the system create a permanent log of work undertaken and generates workflow that automatically appears in the underwriters work queue for action at an appropriate date. All correspondence is also logged on the system. Once the final piece of required information has been obtained by the underwriter the system is updated to reflect this. Once the underwriter is satisfied with the application then a mortgage offer is produced. If the underwriter does not hold an appropriate mandate to authorise the offer then the case is passed to an appropriate mandate holder to do so.

SIRA (Syndicated Intelligence for Risk Avoidance) is used as a fraud detection tool and has been integrated within the process since 2006. Since its re-entry into the buy-to-let market in 2010, Paragon has introduced a fraud policy to ensure both fraud prevention controls and compliance with regulatory requirements is in place.

### **Property Valuation**

Full security assessments and valuation reports are required for each loan. The Paragon Group has 19 regionally based staff surveyors who complete the majority of valuations; the remainder are completed by "panel" surveyors. It is expected that more unusual properties are surveyed by the staff surveyors. All surveys completed by panel surveyors are audited by a Paragon staff surveyor.

Valuation reports are valid for three months. If the valuation is older than three months then a Paragon surveyor has the ability to review the valuation and if appropriate extend it to a maximum of three months. If the valuation is five or more months old and has not been reviewed then a re-inspection must be carried out.

### **Servicing**

PFPLC has an in-house servicing team based in Solihull. The team carries out all administration for PML mortgages and consumer lending. The servicing team is also responsible for all post-completion activities.

PFPLC invested in sophisticated collections technology after adverse credit experience in the early 1990s. At the group's West Midlands headquarters, ongoing contact with borrowers is maintained via a telephone-based debt management system known as CACS. CACS enables collection agents to schedule calls to borrowers upon a missed payment and provides a detailed, diary-based collections management platform. This site has substantial operational history, Fitch considers PFPLC more than adequate in its role as servicer.

PFPLC is not a Fitch-rated servicer of residential mortgage loans. For more information on Fitch's servicer rating programme see the reports titled *Rating Criteria for Structured Finance Servicers*.

### **Early Arrears Management**

All customers are required to make their monthly mortgage payment via direct debit. If a direct debit fails then the servicing team will contact the borrower via telephone within 24 hours of the direct debit failing to ascertain why the payment was not made and to ensure payment will be made.

### **Serious Arrears Management**

If the borrower is two months in arrears, Paragon will appoint a Receiver Of Rent (property agent) on the entire portfolio of the borrower. No court approval is required for this. Paragon will send a surveyor with a property agent to the property and inform the tenant that they have to

send their rent to the ROR, who forwards it on to Paragon, instead of paying the landlord. No monies from that point onwards are allowed to be passed on to the borrower. Payments received in excess of monthly mortgage payment are used to prepay the loans. A locksmith will also change the locks to the property where the property is not tenanted and a decision will be made to either rent or sell the property.

The ROR will review a property that is under their control each quarter to decide whether to continue letting the property or to sell it. The ROR has personal responsibility to act in the best interest of the lender and the landlord and as such has no obligation to return the property to the landlord once the mortgage becomes current. Around one-third of properties that have had a ROR appointed are returned to the borrower. This will only happen if the borrower can demonstrate that the issue that caused the arrears has been resolved and if the loan still meets the current criteria once re-underwritten. Around one-third of the properties are sold and the other third are in churn.

### **Foreclosure, Repossession and Sale**

Once receiver of rent is appointed, the property cannot be sold if a tenancy is in effect unless it is in the best interests of the debt. At the end of the tenancy, Paragon could theoretically extend the tenancy if it chose to, but usually they would obtain vacant possession and sell the property.

### **Standby Servicing**

Fitch considers the continuous, efficient servicing of the mortgage portfolio as fundamental to the successful performance of a mortgage-backed transaction. As such, it monitors that adequate arrangements are in place to ensure continued servicing in the instance that the named servicer in a transaction is unable to perform its duties. HML is the standby administrator.



## Appendix B: Transaction Overview

### Paragon Mortgages (No.23) PLC

UK/Prime RMBS

Figure 7  
Capital Structure

Class	Expected Rating	Size (%)	Size	CE (%)	Interest rate	PMT freq	Maturity	Margin (%)
A1	AAAsf	TBD	TBD (EURm)	11.76	3-month Euribor	Quarterly	Jan 43	TBD
A2	AAAsf	TBD	TBD (GBPm)	11.76	3-month Libor	Quarterly	Jan 43	TBD
B	AAAsf	4.75	TBD (GBPm)	7.01	3-month Libor	Quarterly	Jan 43	TBD
C	A+sf	4.45	TBD (GBPm)	2.56	3-month Libor	Quarterly	Jan 43	TBD
E	Not Rated	2.5	TBD (GBPm)	n.a	3-month Libor	Quarterly	Jan 43	TBD
Reserve fund (%)		2.5						
Liquidity ledger		2.5% of class A,B and C						
First interest payment date		(15 October 2015)						
Issuer call date		(15 October 2019)						

Source: Transaction documents

### Key Information

<b>Closing date</b>	July 2015 Expected	<b>Parties</b>	
<b>Country of assets</b>	UK	<b>Seller</b>	Paragon Mortgages (2010) Limited
<b>Country of SPV</b>	UK	<b>Servicer</b>	Paragon Finance plc
<b>Structure</b>	Sequential	<b>Arrangers</b>	Macquarie Bank Limited, London Branch and Lloyds Bank plc
<b>Settlement</b>	T+3	<b>Joint lead managers</b>	Lloyds Bank plc, Macquarie Bank Limited, London Branch, Morgan Stanley and Natixis
<b>Listing</b>	London Stock Exchange	<b>Principal paying agent</b>	Citibank, N.A., London Branch
<b>Analysts</b>	Kevin Vanistendael Kei Ishidoya	<b>PML Collection account/Transaction account</b>	Barclays Bank plc/Citibank NA, London branch
		<b>Swap counterparties</b>	Macquarie Bank Limited, Lloyds Bank plc

Source: Transaction documents

### Summary

#### Rating drivers

- Buy-to-Let Portfolio:** The portfolio consists entirely of BTL loans for which Fitch applies an increase to the frequency of foreclosure based on its criteria. This is because while BTL loans have performed well in the current environment, they performed worse than owner-occupied properties immediately following the last housing crisis.
- Higher LTV's:** Paragon changed its lending guidelines about a year ago to allow for loans up to 85% LTV (including fees), which is reflected in the larger portion of loans with an LTV over 80% (16.2%) compared to previous transactions. Nearly all the loans in this portfolio have been originated since March 2015.
- High London Concentration:** Within the portfolio, 32.5% of the properties are located in Greater London. While this is typical for BTL pools, it is still much higher than the proportion of the UK population in this region. Fitch views properties in this region to be overvalued and applies a sustainable price discount of 31.1% in its stressed scenarios. In addition, the agency made an adjustment to the default probability for geographical concentration.
- Prime Underwriting, Strong Performance:** Fitch has given credit to Paragon's robust underwriting practices, supported by strong historical performance, with low arrears and defaults outperforming the UK index.
- Liquidity Support:** The first loss fund represents 2.5% of the notes' balance. Of this, a liquidity amount equal to 2.5% of the rated notes is available only to pay interest on classes A, B and C, together with principal receipts in case of a shortfall. The remaining reserve can be used to cure losses.

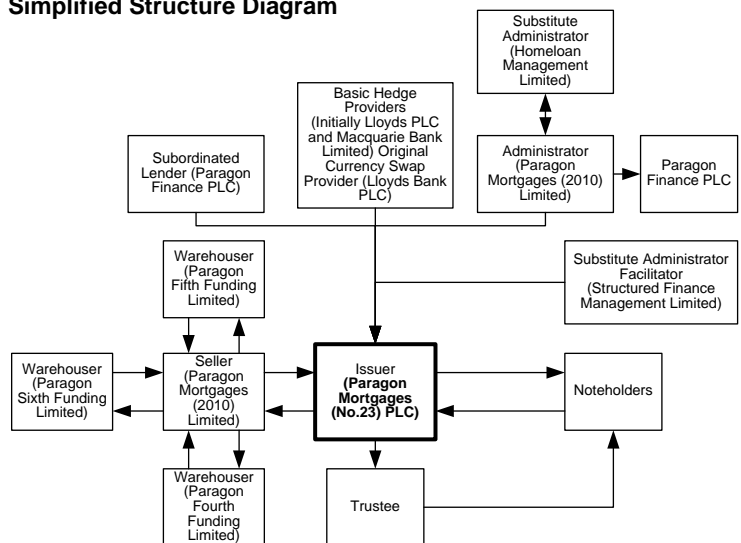
Source: Transaction documents provided by Paragon

### Fitch Default Model Output (Static Pool)

Rating level	AAA	AA	A	BBB
WAFF (%)	23.0	18.6	13.7	9.3
WARR (%)	44.2	49.1	54.0	59.0
WALS (%)	71.1	66.2	59.0	54.1
WAMVD (%)	65.4	61.7	58.0	64.3

Source: Fitch

### Simplified Structure Diagram



Source: Transaction documents

### Collateral Summary

#### Final pool characteristics (As of 31 May 14)

Original principal balance <sup>a</sup>	131,227,302	<b>Regional concentration (%)</b>	
Current principal balance <sup>a</sup>	130,816,463	Greater London	32.5
Average current loan per borrower	174,190	South East	18.9
Number of borrowers <sup>a</sup>	751	South West	8.8
Number of loans <sup>a</sup>	815	East Anglia	9.5
Seasoning (years) <sup>a</sup>	0 (1 month)		
Loan to value (LTV) (%)		<b>Lien position</b>	
WA OLTV	72.7	First ranking	100.0
WA CLTV	72.5	Jumbo (%)	11.3
<b>Mortgage characteristics</b>		<b>Payments</b>	
WA ICR <sup>a,b</sup>	89.4	Payment frequency	Monthly
Buy to Let (%)	100.0	Payment method	Direct debit
		Performing loans (%)	100
<b>Interest rate type</b>		<b>Employment status</b>	
Floating rate loans (%)	13.3	Self-employed (%)	45.7
Fixed rate loans (%)	86.7		

<sup>a</sup> Based on provisional pool, and not the expected final pool at the end of the prefunding period

<sup>b</sup> As calculated by Paragon using Fitch's interest rate assumption of 4% plus the relevant margin

Source: Pool Data provided by Paragon

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