Paragon Mortgages (No.25) PLC

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Related Appendix

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Related Criteria

Global Structured Finance Rating Criteria (May 2017)

EMEA RMBS Rating Criteria (October 2017)

UK Residential Mortgage Rating Criteria Addendum – Residential Mortgage Assumptions (December 2017)

For a full list of applicable criteria please see page 22

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Capital Structure

Class	Expected Rating	Expected Outlook	Amount (GBP)	Size (%)	CE[a] (%)	Interest Rate (%)	Final Maturity
A[b]	AAAsf	Stable	TBD	85.0	15.1	Libor + TBD	February 2050
B[b]	AAsf	Stable	TBD	4.8	10.4	Libor + TBD	February 2050
C[b]	A-sf	Stable	TBD	4.3	6.1	Libor + TBD	February 2050
D[b]	BBB-sf	Stable	TBD	3.5	2.6	Libor + TBD	February 2050
Z[b]	Not rated	n.a.	TBD	2.5	0.0	Libor + TBD	February 2050
S	Not rated	n.a.	TBD	TBD	0.0	Libor + TBD	February 2050
S VFN	Not rated	n.a.	TBD	TBD	0.0	Libor + TBD	February 2050
Total Issuance			**TBD**				

[a] Credit enhancement (CE): Based on a total asset pool of GBP760.8m and the credit part of the amortising general reserve of 0.1% of the initial portfolio balance
[b] Notes backed by the mortgage pool

Transaction Summary

Paragon Mortgages (No.25) PLC is the 25th transaction from the Paragon series consisting of buy-to-let (BTL) mortgages originated by Paragon Mortgages (2010) Limited and Paragon Bank plc (Paragon). The mortgages in the pool have been originated relatively recently, between 2011 and 2017, with 73.2% originated between 2015 and 2017. Unlike the previous transactions in the Paragon Mortgages series, this transaction will feature a five-year revolving period with a scheduled amortisation of the class A notes.

Key Rating Drivers

Prime BTL Originations: Paragon is an experienced lender specialising in the BTL segment with a large proportion of originations to professional landlords with four or more properties. Paragon originates in line with the guidelines introduced by the Prudential Regulation Authority (PRA) and Fitch views Paragon's underwriting standards to be in line with its expectations for a prime BTL lender.

Revolving Transaction: A five-year revolving period, of which the first year is fully revolving, allows new assets to be added to the portfolio. While the replenishment criteria help mitigate risks about the potential migration of the portfolio's credit profile, the risk of some deterioration during the revolving period remains. Fitch assumed changes to the portfolio characteristics, giving credit to the replenishment criteria listed in the transaction documentation where relevant.

Class A Scheduled Amortisation: Principal on the class A notes will be paid in the first instance according to a target scheduled amortisation starting after the first year. In the event that principal collections are not enough to meet the target scheduled amortisation, the amounts will be carried forward.

Hedging Mismatch: Fitch sees a high probability the transaction will become over hedged due to defaults or prepayment, which is negative for the transaction in Fitch's stable and decreasing interest rate scenarios. This is because the initial hedging, and any further hedging required, is based on a 0% constant prepayment rate (CPR) notional. Fitch tested this as part of its cash flow modelling with the approach described further under the section *Hedging and Interest Rate Risk* in this report.

Transaction Comparison[a]

	PM25[b]	PM24	PM23	Gosforth 2017-1[b]	Duncan Funding 2016-1[b]
Closing date	[Apr 18]	Nov 15	Jul 15	Sep 17	May 16
Total issuance (GBP)	TBD	350,110,956	300,029,022	1,151,817,734	3,351,976,000
Ratings (%)					
AAAsf	TBD	84.7	87.3	91.5	91.5
AAsf	TBD	5.5	4.9	0.0	3.5
Asf	TBD	7.3	5.3	0.0	1.5
BBBsf	TBD	0.0	0.0	0.0	0.0
BBsf	TBD	0.0	0.0	0.0	0.0
NRsf	TBD	2.5	2.5	8.5	11.2
Initial reserve (% of initial balance)	1.5	2.5	2.5	0.0	0.0
Target reserve (% of initial balance)	1.5	2.5	2.5	0.0	0.0
WAFF (%)					
AAAsf	22.7	24.0	23.5	16.6	16.4
AAsf	18.5	19.3	18.9	13.5	13.4
Asf	13.9	14.3	14.0	10.2	10.1
BBBsf	9.7	9.7	9.5	7.1	7.1
BBsf	6.1	5.8	5.7	4.6	4.6
WARR (%)					
AAAsf	39.8	43.5	43.8	57.5	55.4
AAsf	44.2	48.4	48.8	63.4	61.0
Asf	48.6	53.2	53.7	69.0	66.3
BBBsf	53.0	58.1	58.6	74.8	71.9
BBsf	57.3	63.0	63.5	79.6	76.6
Portfolio collateral balance (GBP)	760,813,567	348,458,861	281,184,159	1,345,963,935	3,351,141,870
Number of borrowers	3,860	1,872	1,618	7,579	27,297
Av. current balance borrower (GBP)	197,102	186,143	173,785	177,591	122,766
WA seasoning (months)	26	4	3	25	38
WA remaining term (years)	19	21	21	22	20
Loan-to-value (%)					
WA sLTV	98.0	96.5	96.0	85.5	81.4
WA OLTV	71.9	73.2	73.2	65.2	72.0
WA CLTV	71.3	73.0	73.0	61.4	65.2
OLTV >=80%	5.7	14.0	13.6	20.4	40.1
Borrower characteristics (%)					
CCJs	0.0	0.0	0.0	0.0	0.0
BO/IVA	0.0	0.0	0.0	0.0	0.0
<90 arrears	0.0	0.1	0.2	0.0	0.0
90+ arrears	0.0	0.0	0.0	0.0	0.0
WA DTI[c]	n.a.	n.a.	n.a.	45.1	38.4
WA ICR	95.8	84.6	88.6	n.a.	n.a.
Mortgage characteristics (%)					
Buy-to-let	100.0	100.0	100.0	0.0	0.0
Right-to-buy	0.0	0.0	0.0	0.2	0.0
Flexible loans	0.0	0.0	0.0	100.0	0.0
Second-charge loans	0.0	0.0	0.0	0.0	0.0
Interest-only loans	92.1	93.3	91.7	5.6	11.7
Self-employed	57.2	41.9	43.4	23.0	11.8
WA stabilised margin	4.7	4.7	4.7	4.3	2.9

[a] Pool statistics are calculated by Fitch and may differ from figures reported in the offering circular
[b] The WAFF and WARR levels are based on the dynamic levels, which take into account the revolving period of the transaction, while the portfolio stratifications are based on the static pool
[c] WA DTI was calculated applying a Fitch stress rate of 4% to the stabilised margin
Source: Fitch

Transaction Parties

Transaction Parties

Role	Counterparty	Rating
Issuer	Paragon Mortgages (No.25) PLC	n.a.
Originator	Paragon Mortgages (2010) Limited, Paragon Bank PLC	BBB/Stable/F3 (Paragon Banking Group PLC)
Sellers	Paragon Mortgages (2010) Limited, Paragon Bank PLC	BBB/Stable/F3 (Paragon Banking Group PLC)
Administrator/servicer	Paragon Mortgages (2010) Limited, Paragon Bank PLC	BBB/Stable/F3 (Paragon Banking Group PLC)
Account bank	Citibank, N.A., London Branch	A+/Stable/F1
Collection account banks	Barclays Bank PLC, NatWest Bank plc	A/Watch Positive/F1, BBB+/Watch Positive/F2
Principal paying agent	Citibank, N.A., London Branch	A+/Stable/F1
Swap provider	Lloyds Bank plc	A+/Stable/F1
Arrangers	Lloyds Bank plc, Morgan Stanley & Co. International plc	n.a.

Source: Transaction documents and Fitch

Asset Analysis

Lender Adjustment

Fitch's base foreclosure frequencies assume that the origination and underwriting practises 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, the agency performs an operational review of the originator to assess the origination, underwriting and servicing capabilities of the seller (see *Appendix A*). As a result of this review, if Fitch believes that the origination and underwriting procedures are either above or below market standards, an adjustment to the base default probabilities of the whole portfolio can be warranted.

Fitch visited Paragon's head office in December 2017 to focus on its origination practises and servicing abilities. Paragon is an experienced lender specialising in the BTL segment and sourcing its applications primarily though the intermediary market. A large proportion of its originations are to professional landlords with four or more properties, with the average borrower having a portfolio of around 10 properties. This share has increased since the introduction of new BTL lending requirements by the PRA in September 2017. Paragon has fully adopted the new regulation introduced by the PRA.

As part of this site visit, Fitch conducted a small, targeted file review, including a number of cases selected based on certain characteristics that the agency considers indicate higher risk. Fitch had no concerns on the underwriting of the selected cases and noted that the processes and systems were well set-up to deal with the more complex underwriting of professional landlords with larger portfolios.

Fitch considers the lending criteria, as outlined in *Appendix A*, to be in line with the agency's view of a prime lender within the BTL space. Based on a review of Paragon's lending practises, Fitch did not apply any lender adjustment for this transaction.

Lender Strengths and Weaknesses

Paragon Mortgages Limited/Paragon Bank PLC

Strengths	1.	Manual underwriting of all cases and processes and systems in place to deal with professional landlords.
	2.	Strong valuation process and oversight of valuations which includes the use of Paragon's own surveyors.
	3.	Full alignment to the PRA guidelines.
	4.	Robust Receiver of Rent process.
Weakness	1.	A focus on professional landlords which involves more complex underwriting and provides the potential for higher concentration risk.

Source: Fitch

Buy-To-Let

The entire pool consists of 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 shorthold tenancy agreements can generally be evicted more easily than owner-occupiers, while the repossession process through the courts is shorter.

In addition, Fitch notes that Paragon has a strong market position towards professional landlords. 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.

For BTL properties a receiver of rent (ROR) process 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.

Receiver of Rent

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. Generally, if the loan is two or more months in arrears, Paragon will appoint an ROR for the entire portfolio of the borrower, which does not require court approval. Paragon use a wholly owned subsidiary, Redbrick Survey and Valuation Limited (Redbrick), for the ROR process.

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. Any payments received in excess of monthly mortgage payments and associated fees are used to pay down the loan. 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.

Even if a borrower becomes current at a later date, Paragon is not immediately obliged to release the property back to the borrower, which could effectively force a borrower to redeem all the mortgages with Paragon. Instead, Paragon will complete a full re-underwrite and only if the risk is deemed acceptable will the company release control of the property back to the borrower.

Concentration Risk

Potential concentration risk primarily stems from Paragon's business model targeting professional landlords who typically have a number of BTL loans with Paragon. As a result, there are a relatively large proportion of borrowers in the pool with more than one property. The maximum number of properties per borrower is 21, although the average number is only 1.2, as per the preliminary pool. Some of those cases will be loans secured on multiple leaseholds within the same building where the borrower could potentially be the ultimate freehold owner, which would increase the concentration risk relating to individual properties and regional areas. There is also the possibility that those cases would be more challenging with respect to marketability in a repossession or ROR situation.

Cross-collateralisation

Borrowers could potentially have BTL loans with Paragon outside of the securitised portfolio, which would be originated under an all monies charge. Paragon has mitigated the potential for enforcement of a loan within the securitisation based on a default on a loan outside of the securitised portfolio by restricting the rights to cross-collateralisation.

Fitch analysed the exposure to the risks outlined above, as well as the aggregate current loan balance of any single borrower, and determined that the concentration risk was not deemed excessive.

Interest-Only Loans

Of the loans in the preliminary pool, 92.1% are interest only, which is typically the loan type 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 (i.e. balloon payment risk). However, the interest-only foreclosure frequency (FF) adjustment 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.

Self-Employed Borrowers

Self-employed borrowers make up 57.2% 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.

Interest Rate Types

The preliminary pool has 80.6% of loans that pay a fixed rate of interest with a weighted average (WA) time to reversion of 2.3 years. Of the loans 19.4% are floating rate loans that are linked to Paragon's Libor.

Of the loans that are paying a fixed rate of interest, 46.5% will revert to Paragon's SVR and 53.5% will revert to Paragon's Libor.

Property Type

In the provisional pool, 62.1% of the loans are secured against houses and 23.6% are secured against flats. The property types for the remaining loans in the pool have been flagged as maisonettes, 2.8%, and other, 11.5%. Fitch believes that flats are likely to require a larger discount to market value in order to dispose of the property quickly in a foreclosure scenario and applies a higher quick sale adjustment (QSA) for this property type than for houses.

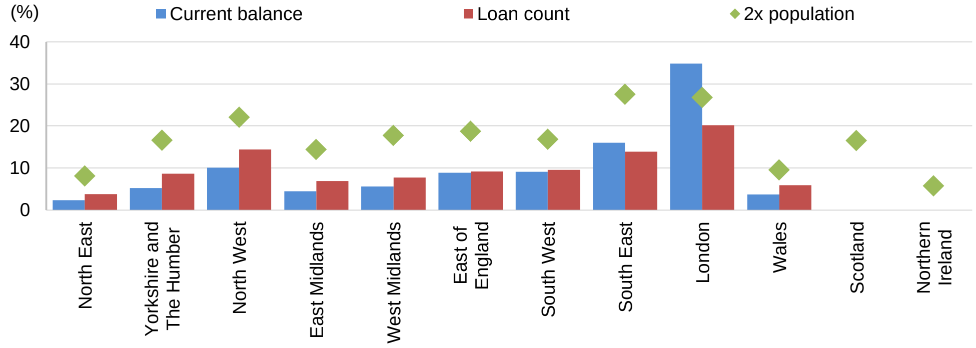
Paragon provided Fitch with a dataset covering 2,404 sold repossessions between 2003 and 2016. Fitch calculated the QSA based on the historical data provided and found that the QSA calculated was higher for houses and flats. The number of observations was deemed to be sufficient for both these property types and Fitch applied a QSA higher than the criteria for houses: QSA applied at 33.0% compared to 27.0% as per criteria, and for flats, QSA applied 37.0% compared to 35.0% as per criteria.

Of the preliminary pool, 11.6% is classified by Fitch as illiquid, which represents property values in the top 5% of the market. Historical portfolio performance shows that high-value properties tend to realise above-average losses, even in times of low stress in the housing market. Where a property value is classified as high, Fitch reduces the distressed property value, after reducing the market value decline (MVD) by an additional illiquidity adjustment factor.

Geographical Concentration

Fitch tests for geographical concentration by comparing the percentage of loans in each region on a loan count basis compared to that region's percentage of the national population. For any region where the loan count exceeds two times the population, Fitch will increase the FF for all loans in that region by 15.0%. The provisional pool displays no geographical concentration in excess of the two times population threshold and no adjustment was therefore made.

Geographic Concentration



Source: Paragon Bank plc, Fitch

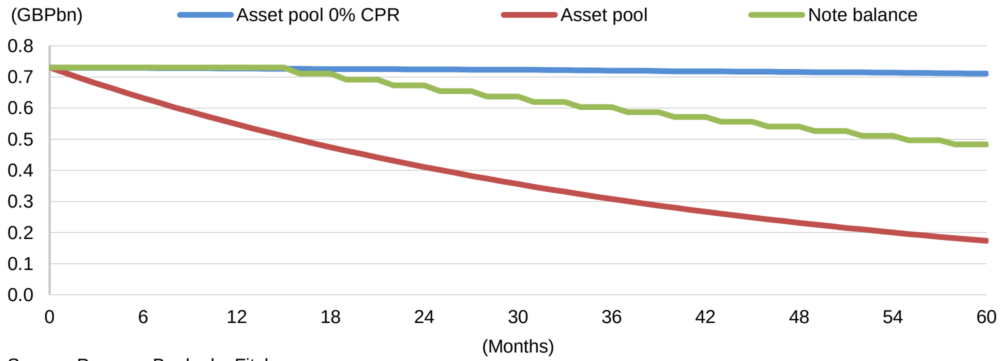
Revolving

A five-year revolving period, of which the first year is fully revolving, allows new assets to be added to the portfolio. The class A notes will amortise during the revolving period according to a target amortisation profile, which has been calculated by assuming an annual CPR of 10%.

Fitch has stressed several asset characteristics to capture the impact of the potential pool deterioration during the revolving period. Where there are restrictions on the concentration of loans containing a feature relevant to Fitch's analysis, this limit has been used to determine the asset quality at the end of the revolving period. Where there are no limits, Fitch assumed a level at which this takes place.

Fitch has made its adjustments to derive portfolio foreclosure and recovery rates as a result of the revolving period at the loan level. To do this, Fitch has determined the percentage of original loans in the pool at the end of the revolving period by applying scheduled amortisation of both assets and liabilities and a CPR of 25%, which is based on historical CPR data from the Paragon series transactions. Under this approach, at the end of the revolving period the pool comprises 36% original loans and 64% replenishment loans.

Pool Replenishment Capacity



Source: Paragon Bank plc, Fitch

Fitch split the pool on a random basis and preserved the loan characteristics of 36% of the pool. For the 64% assumed to be replenishment loans, Fitch made a number of adjustments:

1. CLTV: the transaction stipulates a limit on the WA current loan-to-value (CLTV) of 75% for the pool after adding additional loans to the pool during the revolving period. Fitch has increased the WA CLTV for the total pool up to this limit. The additional loan conditions also set a cap of 15% of the loans with a CLTV above 77%. Fitch assumed a proportion of replenishment loans to have a CLTV of 80% as per Paragon's lending criteria to increase the proportion of the portfolio with a CLTV over 77% to its limit of 15%.
2. Rental Cover: the transaction stipulates a minimum WA interest coverage ratio (ICR) of 145%. Fitch assumed an ICR, by changing the rental income of the replenishment loans in order to reduce the ICR to the stipulated floor of 145%. In order to calculate the rental income of the new loans, Fitch assumed the least conservative way, in respect of the stress rate, of calculating the ICR as per the transaction documentation with a floor of the ICR of 125% as per Paragon's current lending criteria.
3. Arrears: based on historical data and the limit of three-months plus arrears of 3.0% as per the further sale period termination events, Fitch assumed a three-months plus arrears level of 1.5% at the end of the revolving period. Fitch assigned the arrears at the loan level on a random basis and assumed that the loans in arrears would fall in the six-months plus arrears bucket as this is the bucket with the highest FF assumptions as per Fitch's criteria.

For the purpose of calculating stressed asset levels due to the revolving period, Fitch assumed that Paragon maintains consistent lending policies and distribution throughout the revolving period and as a result made no further adjustment for adverse credit or geographic concentration.

In total, the adjustments made to reflect the changes in pool characteristics during the revolving period equate to a 40.1% increase on the static B WAFF.

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.

Fitch Default Model Output

Rating level (%)	WAFF[a]	WARR[b]	MVD[c]
AAA	22.7	39.8	70.5
AA	18.5	44.2	67.4
A	13.9	48.6	64.2
BBB	9.7	53.0	61.0
BB	6.1	57.3	57.9
B	4.2	61.5	54.7

Recovery time (years): Interest accrued on contractual rate for two years at 'AAA'
Recovery cost: 2.5% plus GBP3,000
[a] Weighted-average foreclosure frequency
[b] Weighted-average recovery rate
[c] Market value decline
Source: Fitch

Financial Structure and Cash Flow Analysis

The structure consists of four rated notes where the most senior, class A, will amortise in line with a scheduled amortisation assuming an annual CPR of 10%. The transaction will be fully revolving for the first year and the class A notes will thereafter amortise according to the scheduled amortisation profile until the end of the revolving period. After the revolving period, the notes will amortise sequentially. Fitch took into account the potential for pool migration during the revolving period in its asset analysis as outlined in the *Revolving* section above.

The transaction allows for conversions, including product switches and conversions to interest-only from repayment or vice versa as part of an arrears management programme. New fixed-rate loans, either as a result of a product switch or addition of fixed-rate replenishment loans, will be subsequently hedged to mitigate the interest rate risk. The subsequent hedging will be based on a 0% CPR swap notional where the issuer will pay a fixed rate of interest and receive three-month Libor.

As the swap notional is reflective of no CPR and no defaults, there is a high probability that the transaction will become over hedged due to either defaults or prepayments. This is credit negative for the transaction, and has an impact in Fitch's cash flow modelling, especially in stable and decreasing interest rate scenarios. Fitch's approach to the hedging mechanics is described further under the section *Hedging and Interest Rate Risk*.

Simplified Revenue Priority of Payments

1	Senior fees
2	Amounts due to the swap counterparty other than subordinated amounts
3	Class A interest
4	Class A PDL
5	Class B interest
6	Liquidity reserve fund up to required amount
7	Class B PDL
8	Class C interest
9	Class C PDL
10	Class D interest
11	Class D PDL
12	Issuer profit amount
13	General reserve fund up to its required amount
14	Class Z PDL
15	Prior to step-up, mortgage margin reserve fund and conversion margin reserve fund discretionary amount
16	Third-party expenses
17	Hedge provider subordinated amounts
18	Following the step-up date or final redemption date, applied as principal
19	Class Z interest

Source: Transaction documents, Fitch

Simplified Principal Priority of Payments

1	Principal applied to meet senior expenses deficit
2	Mandatory further advances
3	Discretionary further advances
4	During revolving period, class A target notional
5	During revolving period, consideration for additional loans and amounts to retained principal
6	Class A principal
7	Class B principal
8	Class C principal
9	Class D principal
10	Class Z principal

Source: Transaction documents, Fitch

Step-Up in Margin on Notes

From the interest payment date (IPD) in May 2023, the issuer has the option to call all notes outstanding. In the event that the issuer does not exercise this option, the margin on the class A to class D notes would step up. Fitch has assumed in its cash flow analysis that the call option is not exercised and the margins on the notes step up.

Step-Up Margins

Class	Initial margin (%)	Step-up ratio (x)[a]	Step-up margin (%)
Class A	TBD	1.5	TBD
Class B	TBD	1.5	TBD
Class C	TBD	1.5	TBD
Class D	TBD	1.5	TBD

[a] Capped at +100bp
Source: Fitch

Events of Default

Events of default under the terms and conditions are:

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 most senior class within 15 days following the due date;
3. breach of contractual obligations by the issuer under the transaction documents, which is incapable of remedy or which is, if capable of remedy, not remedied within 30 days and which is materially prejudicial to the interests of the holders of the most senior class;
4. an insolvency event occurs in relation to the issuer; or
5. it is or will become unlawful for the issuer to perform or comply with its obligations.

Optional Redemption

All the notes outstanding can be redeemed in full as follows:

a) mandatory redemption in whole on the legal maturity date;

b) mandatory redemption in whole pursuant to a portfolio purchase;

c) optional redemption in whole exercisable by the issuer where the principal amount outstanding of all the notes is equal to or less than 10% of the aggregate principal amount outstanding of the notes as at the closing date;

d) optional redemption in whole exercisable by the issuer on or after the step-up date; and

e) optional redemption in whole exercisable by the issuer for tax reasons.

Credit Enhancement

Subordination

Credit enhancement (CE) is provided by the notes subordinate to each respective class. For the class A notes for example, CE from subordination is 15.0% and stems from losses being absorbed first by the class B to class Z notes.

General Reserve Fund

The structure will benefit from a general reserve fund (GRF), which will be funded at 1.5% of the class C and D notes. The GRF is available to cover interest shortfalls and principal shortfalls on the rated notes, and senior expenses. The GRF will have an ongoing target amount of 1.5% of the outstanding class C and D notes, but will stop amortising if there is a breach of any of the required amount triggers.

Liquidity Reserve Fund

A fully funded LRF will be established at close to 1.5% of the initial balance of the class A and B notes. The LRF can amortise with a target amount of 1.5% of the class A and B note balance but will stop amortising if there is a breach of any of the required amount triggers. The amortisation is not subject to a floor. The LRF is only available to cover senior expenses and interest shortfalls on the class A and B notes.

Required Amount Triggers

Both the GRF and LRF will stop amortising if there is a breach of any of the required amount triggers. The triggers cover the occurrence of the following:

- On any principal determination date (PDD), the current balance of mortgages three months plus in arrears is more than 3.0%.
- On any PDD, the aggregate amount debited to the principal deficiency ledger (PDL) since closing exceeds 1.0% of the initial principal balance of the class A to Z notes.

The triggers to stop the amortisation of the GRF and LRF are not curable.

Mortgage Margin Reserve Fund

A mortgage margin reserve fund will be established at closing and will be used to cover for any shortfall between the WA interest rate charged and three-month Libor plus 3.0% (as calculated by the administrator and referenced to the Mortgage MRF Libor as per the transaction documentation) and thereafter funded discretionally until the step-up date. The required amount on any subsequent further sale date or IPDs will be the sum of all monthly mortgage margin requirements plus additional amounts which the administrator determines sufficient for the above condition to be met upon acquisitions of additional loans during the next collection period. The monthly mortgage margin requirement is calculated to capture the shortfall between the WA charging interest rate and three-month Libor plus 3.0% for all mortgages purchased at closing and subsequent additional loans purchased during the revolving period taking into account any hedging for fixed-rate loans. The monthly mortgage margin requirement is floored at zero.

The sum of the monthly mortgage margin reserve requirements will be released to the revenue waterfall supplementing the revenue generated from mortgage interest.

Conversion Margin Reserve Fund

Similar to the mortgage margin reserve fund above, the transaction benefits from a conversion margin reserve fund. If a borrower product switches to a fixed-rate product, the required amount will be equal to the reduction in the annual interest rate as a result of the conversion.

A conversion margin discretionary fund will be established at close from the proceeds of the issuance of the Class S notes at close, which can be used to top up the conversion margin reserve fund to its required amount, and thereafter funded discretionally up to its required amount. Any release amounts from the conversion margin reserve fund will be credited to available revenue funds.

Further Advances and the Further Advance Pre-Funding Reserve

Further advances in the mortgage pool with take the form of either mandatory further advances or discretionary further advances. In the provisional mortgage pool, around 3.0% will be subject to mandatory further advances which will be covered by the amounts standing to the credit of the further advance pre-funding reserve in first instance. Mandatory further advances are required to be made to borrowers for advancing funds retained pending completion of construction or refurbishment. A mandatory further advance pre-funding reserve, fully funded at closing through the proceeds of non-collateralised notes, will be established to fund any mandatory further advances on any further sale date prior to the step-up date.

At its discretion, Paragon will decide to make a discretionary further advance subject to certain conditions including:

1. there is no PDL balance on the preceding IPD;
2. the general reserve is at its required amount;
3. the discretionary further advance must be secured on the relevant property owned by the borrower;
4. the current balance of mortgages that are more than three-months plus in arrears is less than 2.0%;
5. the borrower is not in breach of the mortgage conditions;
6. the CLTV did not exceed 75.0% on the immediately preceding principal determination date;
7. the current balance of the 20 largest borrowers did not exceed GBP40 million on the last principal determination date;
8. the amount standing to the credit of the principal ledger is sufficient to pay the class A notes according to the target scheduled amortisation on the next IPD.

The cumulative amount of mandatory and discretionary further advances cannot exceed 16.0% of the initial principal amount of the notes.

Principal to Pay Interest

Principal funds can be used to cover senior expenses and interest payments on the class A and B notes, to the extent revenue (including the GRF and LRF) is insufficient to pay these items. After the use of available revenue funds, the GRF and the LRF, principal can be used to pay senior expenses including interest on the class A and the class B notes. Principal cannot be used to pay interest on the class B notes if the debit balance on the class B PDL exceeds 50.0% of the outstanding balance of the class B notes.

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. Excess spread 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 tenors), then there is further compression of excess spread. However, in this pool, the margins are similar across all loans, which mitigates this specific risk.

Notes Amortisation

Prior to a pass-through trigger event, principal for the class A notes is paid, in the first instance, according to a target scheduled amortisation. Any excess principal collection is used to purchase additional mortgages from the sellers. In the event the principal collections are not enough to meet the target scheduled amortisation, then the class A notes receive all available principal receipts and any unpaid principal will be carried forward. If there is a pass-through trigger event, the notes are paid down on a pass-through basis.

Fitch has considered two scenarios for the note amortisation and occurrence of a pass-through trigger event in its analysis.

1. No pass-through amortisation event occurs. The class A notes are paid subject to its scheduled amortisation until the step-up date five years after closing. For this scenario, the default timing has been delayed by 60 months to start at the end of the revolving period.
2. A pass-through amortisation event occurs immediately after closing. The transaction moves directly to pass-through amortisation and no scheduled amortisation is applied.

Of the tested scenarios, Fitch found that (1) is more stressful for the notes. Fitch has assigned ratings based on the results of this scenario.

Hedging and Interest Rate Risk

The preliminary pool consists of 80.6% of fixed-rate loans that will either revert to Paragon's standard variable rate (SVR) or Libor. The WA interest charged in the preliminary pool tape is 3.8% as at the cut-off date. The fixed-rate loans have a WA time to reversion of 2.3 years with the longest fixed rate period being 5.0 years.

There is an interest rate swap in place to hedge the interest rate risk in the transaction, with a fixed swap notional based on a 0% CPR schedule for the fixed-rate loans. Under the swap agreement, the issuer pays a fixed rate to the swap counterparty and receives three-month Libor.

Additional Fixed-Rate Loans

Additional fixed-rate loans added to the transaction, either through product switches or through the sale of additional loans during the revolving period will be hedged subsequently by the issuer through entering into new swap agreements. Under the new swap agreements, the issuer pays a fixed rate to the swap counterparty and receives three-month Libor based on a 0% CPR notional schedule of the added fixed-rate loans. The issuer is required to enter into new swap agreement s within 30 days of the inclusion of additional fixed-rate loans.

Additional Fixed-Rate Loans Modelling Approach

Since the swap schedule for the initial swap and every subsequent swap agreements entered into by the issuer will be based on 0% CPR profiles there is a risk that the issuer will be over hedged if the new fixed-rate loans either default or prepay. An over hedged position is detrimental for the transaction in Fitch's stable and decreasing interest rate scenarios.

The risk resulting from the over hedged position is primarily mitigated through the following conditions, limiting the addition of new fixed-rate loans:

1. the sale of additional loans and product switches (both potentially increasing the share of fixed-rate loans) can only happen up to the step-up date;
2. a condition of adding new fixed-rate loans, either through additional loans or product switches, is that the maximum over hedged position is limited to GBP10 million;
3. the addition of fixed-rate loans will not result in the WA time to reversion, multiplied by the share of fixed-rate loans, exceeding two years; and

4. the WA portfolio swap rate cannot exceed 4.0% after entering into new swap agreements to hedge additional fixed-rate loans included in the pool.

For a full list of conditions associated with the addition of new fixed-rate loans through additional loans and product switches, please see the *Product Switches/Additional Loan* section under *Transaction and Legal Structure*.

Based on the conditions regarding additional loans and product switches, Fitch assumed the transaction to be over hedged up to the limit of GBP10 million through the revolving period in its stable and decreasing interest rate scenarios. In addition and in order to capture the effect of defaults and CPR, which both increase the potential over hedging at the end of the revolving period, Fitch ran two scenarios assuming product switches to occur just before the revolving period ends (five years after transaction closing):

1. for the first scenario, Fitch assumed that 100% of the borrowers product switch to a fixed-rate two-year product;
2. for the second scenario, Fitch assumed that 40.0% of the borrowers product switch to a five-year product, i.e. the exposure period is increased by three years albeit with a lower notional balance.

The swap rate assumed for the hedging of new fixed-rate mortgages was assumed to be 4.0% in line with the transaction documentation. Fitch assumed that all of the loans, irrespective of the scenarios above, revert to Paragon's SVR.

Fitch found that scenario 2 was more detrimental to the structure in the stable and decreasing interest rate scenario and assigned ratings based on this scenario.

SVR vs. Three-Month Libor

In the preliminary pool, 46.5% of the fixed-rate loans will revert to Paragon's SVR, currently set at 5.35%. In addition, there is a limit on the current balance of loans paying or reverting to Paragon's SVR of 75.0% as a condition for additional loans being added to the pool.

The basis risk between the SVR loans and three-month Libor remains unhedged, which Fitch has taken into account in its cash flow modelling. Fitch has assumed that the long-term spread between the SVR and three-month Libor in a rising interest rate scenario is 3.0%. For the stable and decreasing interest rate scenarios, Fitch assumed the spread to three-month Libor to be the current margin, minus 50bp.

Further Margin Compression During Revolving Period

Fitch applied further margin compression in its cash flow modelling, taking into account the possibility of adding new floating rate loans during the revolving period. The amount of new floating rate loans added was calculated assuming a CPR of 25.0% which was in-line with the approach taken to calculate the transaction's replenishment capacity as described in the *Revolving* section above under *Asset Analysis*. The loan margins for additional floating rate loans was set to three-month Libor + 3.0%, which is in-line with the conditions around the overall pool margin as outlined in the *Product Switches/Additional Loan* section under *Transaction and Legal Structure*.

Scenario Testing

Fitch tested the structure under all combinations of front- and back-loaded default distributions, high/low prepayment rates, and rising/stable/decreasing interest rate environments, as per its *EMEA RMBS Rating Criteria.* The agency has found that a scenario involving high prepayments, rising interest rates and a back-loaded default distribution was the most detrimental to the class A notes.

Rating Sensitivity[1]

This section of the report provides an insight into the model-implied rating sensitivities to hypothetical changes in defaults and/or recoveries on the assets in a stressed environment. These increased defaults and/or recoveries on assets are relative to the dynamic WAFF of the mortgage portfolio (22.7% for the 'AAAsf' rating scenario) and the dynamic WARR of the mortgage pool (39.8% for the 'AAAsf' rating scenario). The model-implied rating sensitivities, based on such assumptions, are only indicative of some of the potential outcomes and do not consider other risk factors to which the transaction is exposed.

Rating Sensitivity to Defaults

	Class A	Class B	Class C	Class D
Original Rating	AAA	AA	A-	BBB-
A 15% increase in default rates	AA+	AA-	BBB+	BB+
A 30% increase in default rates	AA	A+	BBB	BB+

Source: Fitch

Rating Sensitivity to Recovery Rates

	Class A	Class B	Class C	Class D
Original Rating	AAA	AA	A-	BBB-
A 15% decrease in recovery rates	AA+	AA-	BBB+	BB+
A 30% decrease in recovery rates	AA+	A+	BBB	BB+

Source: Fitch

Rating Sensitivity to Defaults and Recovery Rates

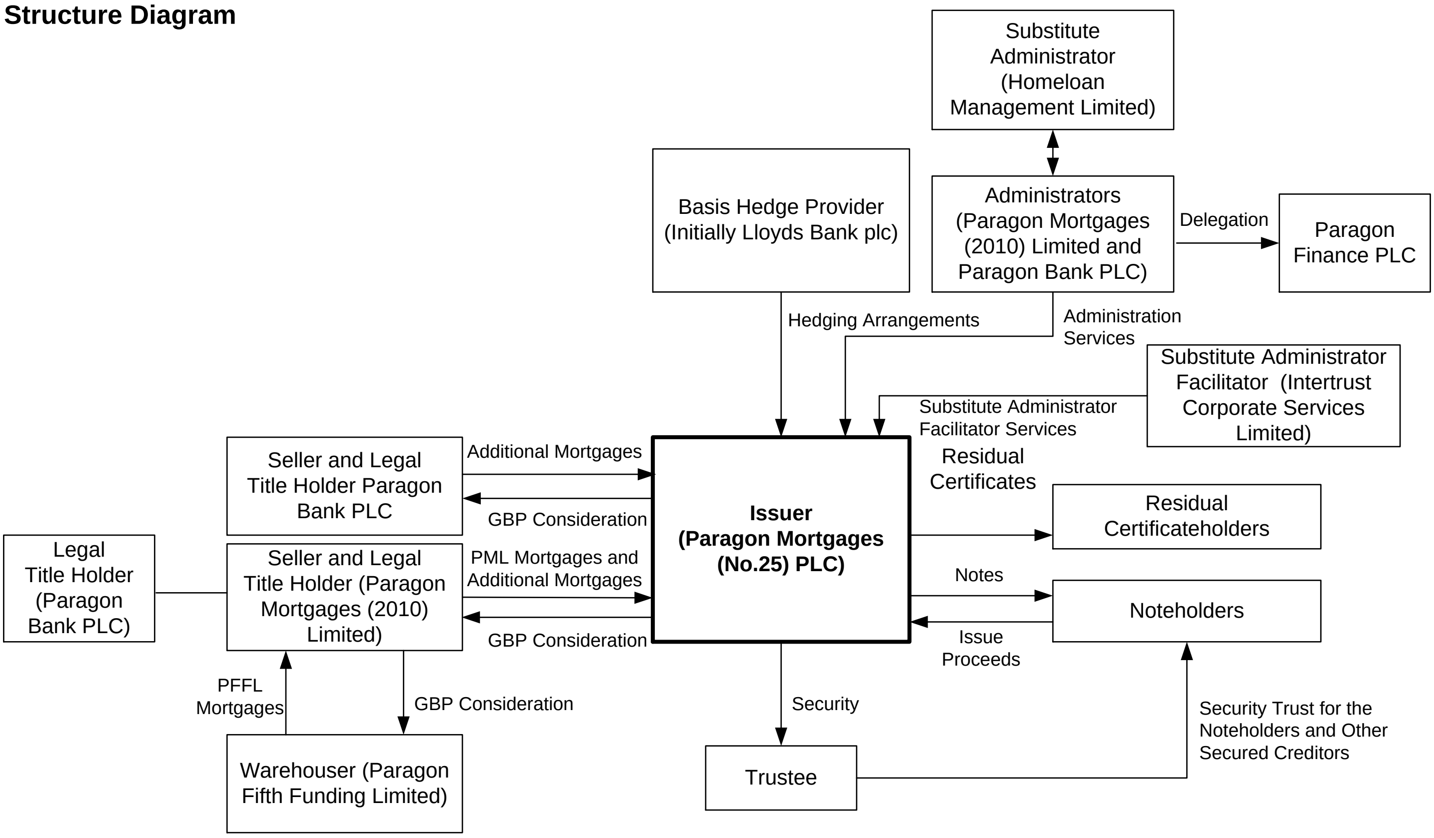
	Class A	Class B	Class C	Class D
Original Rating	AAA	AA	A-	BBB-
Default rate increase of 15%, recovery rate decrease of 15%	AA	A+	BBB	BB+
Default rate increase of 30%, recovery rate decrease of 30%	A+	A-	BB+	BB

Source: Fitch

[1] These sensitivities only describe the model-implied impact of a change in one or more 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.

Transaction and Legal Structure

Structure Diagram



Source: Fitch, Transaction document

Legal Framework

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

At closing, the issuer will enter into a deed of charge, creating security over the collateral in favour of the trustee as security for (among other amounts) all payments under the notes. The security includes first fixed charges and floating charges in favour of the trustee on all the issuer‘s rights, claims, title, benefit, security and interest in and to the underlying collateral. The legal title to the loans will only be vested to the issuer once certain perfection events occur under the terms of the mortgage sale agreement. These include the service of an enforcement notice, the trustee determining that the charged property or any part thereof is in jeopardy (including due to the possible insolvency of the legal title holder), certain insolvency events of the legal title holder, or the legal title holder becoming obliged to provide notice of assignment of the loan by order of court, by law or any relevant regulatory authority.

Representations and Warranties

The mortgage sale agreement contains representations and warranties (R&W) given by the seller in relation to the mortgage pool. All of the relevant representations and warranties described in Fitch’s *Representations, Warranties, and Enforcement Mechanisms in Global Structured Finance Transactions* report are present in the mortgage sale agreement. A more detailed breakdown of the RW can be found in the related Appendix, at www.fitchratings.com.

Revolving Period Replenishment Criteria

The portfolio will have a revolving period of five years, during which the seller will be permitted to sell, and the issuer entitled to purchase, additional loans and their related security. Any additional loans must meet the replenishment criteria below to be included in the portfolio:

- the relevant further sale date falls on a date prior to the step-up date;
- no seller asset warranty is breached in respect of additional mortgages and the seller is not in breach of its obligation to repurchase mortgages which are in breach of any seller asset warranty;
- following the addition of the additional mortgages the WA CLTV will not exceed 75.0%;
- the WA interest rate applicable to the current balance of all mortgages, after taking into account hedge agreements, is not less than three-month Libor + 3.0%, as calculated by the administrator and referenced to the Mortgage MRF Libor as per the transaction documentation, or if the WA interest rate is less than three-month Libor + 3.0%, the amount standing to the mortgage margin reserve fund is equal to or greater than its required amount;
- the amount standing to the credit of the MFA pre-funding reserve ledger or the principal ledger is sufficient to cover mandatory further advances;
- the administrator will within 30 days arrange for the issuer to hedge the fixed floating interest rate exposure for additional fixed-rate loans;
- following the addition of the additional mortgages the proportion of loans with a CLTV of more than 77.0% will not exceed 15.0%;
- following the addition of the additional mortgages the proportion, by current balance, of loans in London will not exceed 40.0%;
- following the addition of the additional mortgages the proportion, by current balance, of loans in South East England will not exceed 40.0%;
- following the addition of the additional mortgages the proportion, by current balance, of loans in a single geographic region other than London and South East England will not exceed 20.0%;
- following the addition of the additional mortgages the WA rental cover is not less than 145.0%;
- the remaining fixed-rate period for a fixed-rate mortgage will not be longer than 5.5 years as at the relevant further sale date;
- other than in respect of non-reversionary Libor-linked mortgages, the reversionary interest rate is either (i) three month Libor plus a margin equal to or greater than 4.5% or (ii) the relevant legal title holder's SVR;
- following the addition of the additional mortgages the balance of loans paying or reverting to the SVR is not greater than 75.0%;
- the amount standing to the credit of the principal ledger on the relevant further sale date is sufficient to pay the class A notes according to the target scheduled amortisation;
- no further sale period termination event has occurred or would occur as a result of the sale and purchase of the relevant additional mortgages;
- no additional mortgage to be purchased is more than one month in arrears;
- as at the relevant further sale date, more than 50.0% of the residual certificates are held by a Paragon Banking Group entity;
- there was no debit balance on the PDL on the preceding IPD;
- following the addition of the additional mortgages the aggregate current balance of all

additional mortgages shall not exceed 30.0% unless an agreed upon procedures (AUP) report has been carried out following the principal determination date when the aggregate balance exceeded 20.0%;

- following the addition of the additional mortgages, such additional mortgages shall not cause the balance of the non-reversionary Libor-linked mortgages to be greater than 20.0% on such further sale date;
- on such further sale date, the WA swap rate as calculated by the administrator does not exceed 4.0%;
- on each further sale date, additional loans with a deposit balance in excess of GBP85,000 (FSCS limit) may only be purchased if the sum of the amounts, calculated as the lower of the deposit amount above the FSCS limit and the mortgage balance, in the portfolio, including the additional mortgages, does not exceed 0.5%;
- on each further sale date, the product of the WA time in years to the end of the fixed-rate period for fixed-rate mortgages and the current balance of fixed-rate mortgages, including additional fixed-rate mortgages, divided by the current balance of all mortgages in the pool, does not exceed two;
- on each further sale date, the notional balance of the swap(s) must not exceed or be less than GBP10 million of the fixed-rate balance including additional fixed-rate mortgages; and
- that a Paragon Banking Group company is the administrator and no administrator termination event has occurred in respect of any Paragon Banking Group company.

Fitch considers the replenishment criteria sufficient to mitigate many of its concerns about the potential migration of the portfolio's credit profile.

Fitch stressed the default model output to take account of the revolving period (see *Asset Analysis* for more details).

Pass-Through Trigger Events

The class A notes will receive principal according to a scheduled amortisation profile, calculated assuming an annual CPR of 10%, before a pass-through trigger event occurs. Such events include the following:

- an event of default;
- an insolvency event regarding the sellers;
- an unremedied breach of the transaction documents by the sellers;
- on any IPD, the aggregate amount debited to the PDL in respect of enforcement of mortgages since closing exceeds 1.0% of the initial principal amount of the class A to Z notes;
- the amount standing to the credit of the GRF is less than the GRF required amount;
- the amount standing to the credit of the LRF is less than the LRF required amount; and
- on any principal determination date, the current balance of mortgages more than three months in arrears is above 3.0%.

After a pass-through trigger event, scheduled amortisation of the class A notes will cease and available principal will be used sequentially to redeem each note in full on a pass-through basis.

Conversion of Mortgages (Product Switches)

The transaction allows for conversions, including product switches and conversions to interest-only from repayment or vice versa as part of an arrears management programme. The administrator shall on the last business day of each month identify mortgages subject to conversions and make sure that the following conditions were satisfied in respect of such mortgage:

- no event of default has occurred which is then continuing unwaived at the time of the proposed conversion;
- that the interest rate converted mortgage will be on the terms of the relevant mortgage documentation which terms have not been varied in any material respects other than in respect of the interest rate applicable;
- that the conversion is effected by such means as would be adopted by a reasonably prudent mortgage lender;
- no conversion shall extend the final maturity date beyond 30 April 2048;
- if the mortgage is converted into a fixed-rate mortgage, the administrator shall within 30 days enter into a hedge agreement to hedge the fixed floating interest rate exposure;
- as at the date of conversion, the WA swap rate as calculated by the administrator does not exceed 4.0%;
- as at the date of conversion, the product of the WA time in years to the end of the fixed-rate period for fixed-rate mortgages, together with the mortgages to be converted to fixed-rate mortgages, and the current balance of fixed-rate mortgages, together with the mortgages to be converted to fixed-rate mortgages, divided by the current balance of all mortgages in the pool, does not exceed two;
- as at the date of conversion, the notional balance of the swap(s) must not exceed or be less than GBP10 million of the fixed-rate balance including additional fixed-rate mortgages.
- the relevant borrower in respect of such interest rate converted mortgages is not more than one month in arrears;
- the conversion takes place on or prior to the step-up date;
- as at the conversion date, the amount standing to the credit of the conversion margin reserve fund is equal to or greater than the required amount;
- that Paragon Mortgages Limited and/or Paragon Banking Group and any holding company or subsidiary of Paragon Banking Group is the administrator and no administrator termination event has occurred; and
- as at the relevant further sale date, more than 50.0% of the residual certificates are held by a Paragon Banking Group entity;

If any of the conditions above are breached the loan subject to a product switch will need to be repurchased by Paragon.

Substitution

The transaction does not contain a mechanism by which loans can be substituted during the life of the transaction. If any loan is found to be in breach of the R&Ws or is subject to a product switch and any of the related conditions are breached, that loan will be repurchased by the seller.

Disclaimer

For the avoidance of doubt, Fitch relies, in its credit analysis, on legal and/or tax opinions provided by transaction counsel. As Fitch has always made clear, Fitch does not provide legal and/or tax advice or confirm that the legal and/or tax opinions or any other transaction documents or any transaction structures are sufficient for any purpose. The disclaimer at the foot of this report makes it clear that this report does not constitute legal, tax and/or structuring advice from Fitch, and should not be used or interpreted as legal, tax and/or structuring advice from Fitch. Should readers of this report need legal, tax and/or structuring advice, they are urged to contact relevant advisers in the relevant jurisdictions.

Impact of Banking Act 2009 and Related Secondary Legislation

The Banking Act 2009 and related secondary legislation (the Act) confers wide-ranging powers on the UK financial authorities to deal with the failure (or likely failure) of certain UK incorporated entities, including authorised deposit-taking institutions and investment firms. The greatest element of uncertainty arises from the provisions in the Act which empower the authorities to potentially override the ongoing contractual obligations of a financial institution (or a related group company) in a structured finance transaction. This could have potential implications for the enforceability of contractual or servicing arrangements within structured finance transactions.

In Fitch's opinion, the Act is not expected to affect ratings for structured finance transactions. This is based on a number of factors, including the government commitment to reviving the mortgage-backed security markets, which are considered important in reviving the capacity of lenders to provide funding in the economy.

Notwithstanding Fitch's view that it does not expect the ratings to be affected, the agency will continue to monitor future developments with respect to the Act to determine whether there could be any rating impact to the transaction.

Operational Risk

Paragon, as administrator, has delegated its responsibilities to Paragon Finance, which is responsible for administering the mortgage loans in the portfolio. Paragon Finance currently acts as servicer for all Paragon's outstanding RMBS transactions. Fitch considers the primary and special servicing capabilities of Paragon to be satisfactory.

Homeloan Management Limited (HML), now known as Computershare Loan Services, has been appointed as back-up administrator and is required to write and test the relevant programmes required to read the data from the administrators. In addition, Intertrust Corporate Services has been appointed as substitute administrator facilitator. Fitch considers the available liquidity to be satisfactory to withstand a period of payment interruption due to the replacement of the administrators.

Criteria Application, Model and Data Adequacy

Criteria Application

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 the agency's assessment of historical house price movements and mortgage defaults in the UK. Its study showed that a borrower's LTV ratio, reflecting the size of their down-payment and their willingness to pay, and a borrower's debt-to-income (DTI) ratio, or in the case of BTL loans the ICR, reflecting their ability to pay, to be the key determinants of default probability in the UK.

Paragon provided Fitch with a loan-by-loan-level data template. The data quality and availability was satisfactory, with no material data fields missing. The collateral review of the mortgage portfolio 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 discount.

Paragon provided Fitch with a dataset covering 2,404 sold repossessions between 2003 and 2016. Fitch calculated the QSA based on the historical data provided and found that the QSA calculated was higher for houses and flats. The number of observations was deemed to be sufficient for both these property types and Fitch applied a QSA higher than the criteria for houses: QSA applied at 33.0% compared to 27.0% as per criteria, and for flats, QSA applied 37.0% compared to 35.0% as per criteria.

Fitch conducted a file review of a sample of loan files with the review focusing on the underwriting procedures conducted by Paragon compared to Paragon's credit policy at the time of underwriting. Furthermore, Fitch reviewed the results of agreed-upon procedures (AUP) report conducted on the asset portfolio information, which indicated no adverse findings material to the rating analysis.

Model

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

ResiEMEA

EMEA Cash Flow Model

Data Adequacy

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

Counterparty Risk

Originator

Fitch completed a review of the origination policies and underwriting practises of Paragon during the 12 months preceding the transaction. Some of the files were selected randomly while others were selected based on certain characteristics Fitch considers indicate higher risk. No areas for concern were identified with the loans that were reviewed. The quality of the underwriting was found to be in line with that expected of a prime BTL lender. For further information, please see *Appendix A: Origination and Servicing*.

Account Bank

The transaction account and swap collateral account are held with Citibank N.A., London Branch. Upon a downgrade of the account bank below 'A' or 'F1', the issuer will be required to replace the transaction account bank with a suitably rated ('A' or 'F1') bank or financial institution within 30 calendar days.

Commingling Risk

Commingling risk analysis estimates the potential loss to the transaction resulting from the loss of funds held in the collection account bank upon default of either the collection account bank holder or collection account bank. Such amounts include cash holdings at the time of the counterparty default, as well as any subsequent payments to the defaulted counterparty. Fitch has analysed the bank account structure, counterparties and replacement triggers to assess whether commingling risk has been mitigated in line with its counterparty criteria.

The collection accounts are held with Barclays Bank plc and NatWest Bank plc and will have rating triggers in place set to ‘BBB+’ or ‘F2’. There is a declaration of trust in favour of the issuer over each account. There is a daily sweep from the collection accounts to the issuer account bank held with Citibank N.A. London Branch.

Based on the collection distribution profile, Fitch deemed the commingling exposure to be material. Since the rating triggers are not in line with the required triggers for material exposures, ‘A’ or ‘F1’, Fitch assumed one month loss of scheduled principal and interest, and 10% of one month loss of prepayments. In line with Fitch’s published criteria, this was sized using its equilibrium interest rate of 4.0% and a base case CPR assumption of 25.0%.

The commingling loss was applied in the 15th month after closing. The transaction allows for principal funds subject to commingling losses to be included in the provisioning. Fitch therefore added these to the PDL at the time of the loss being incurred.

Set-off Risk

One of the sellers, Paragon Bank, is a deposit taking institution. In the event of insolvency of Paragon Bank, borrowers who also have deposits with Paragon Bank could exercise their right of deposit set-off. Based on data received by Paragon on deposit balances of borrowers above the FSCS limit and based on the limit on such borrowers as per the additional mortgage conditions, Fitch deemed the set-off exposure immaterial and therefore no adjustment was applied.

Administrator/Servicer

Paragon, as administrator, has delegated its responsibilities to Paragon Finance, which is responsible for administering the mortgage loans in the portfolio. Paragon Finance currently acts as servicer for all Paragon’s outstanding RMBS transactions. Fitch’s considers the primary and special servicing capabilities of Paragon to be satisfactory.

Hedge Provider

Interest Rate Swap

There is a fixed notional swap in place to hedge the interest rate risk resulting from the fixed-rate mortgages and the floating rate notes. The issuer pays a fixed rate to the swap counterparty and receives three-month Libor. The swap provider for the initial swap is Lloyds Bank plc, rated ‘A+’/‘Stable’/‘F1’, which is a rating in line with Fitch’s counterparty criteria. Upon a downgrade of Lloyds below ‘A’ or ‘F1’, within 30 calendar days, one of the following remedial measures must be taken according to the transaction documents:

1. arrangement for a third-party guarantor with the requisite rating;
2. transfer of the swap to a counterparty with the requisite rating; or
3. post collateral within 14 days in compliance with the credit support annex.

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

Combined Adjustments

Fitch made no adjustments to the FF in its analysis. This adjustment is discussed in the relevant section of this report and summarised in the table below.

Adjustments

		FF multiple
1	Base lender adjustment	1.0
	Total	**1.0**

Source: Fitch

Surveillance

Fitch will monitor the transaction regularly and as warranted by events. Its structured finance performance analytics team ensures that the assigned ratings remain, in the agency's view, an appropriate reflection of the issued notes' credit risk. On a quarterly basis, Fitch expects to receive the investor report, together with the updated loan portfolio and details of restructured loans. Details of the transaction's performance will be available to subscribers at www.fitchratings.com.

Related Research

Publication

General structured finance Rating criteria	
Global Structured Finance Rating Criteria	May 2017
EMEA RMBS Rating Criteria	October 2017
Structured Finance and Covered Bonds Country Risk Rating Criteria	September 2017
Counterparty risk criteria	
Structured Finance and Covered Bonds Counterparty Rating Criteria	May 2017
Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum	May 2017
Interest-rate criteria	
Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria	February 2018
Sector and country-specific criteria	
UK Residential Mortgage Rating Criteria Addendum – Residential Mortgage Assumptions	December 2017

All the above research is available at www.fitchratings.com
Criteria can be updated or amended: Readers should always make reference to the last criteria available at www.fitchratings.com
Source: Fitch

Appendix A: Origination and Servicing

Originator Overview

Originator	Paragon Mortgages (2010) Limited, Paragon Bank plc
Assessment date	December 2017
Total lending volume	GBP9,840,000,000
Product mix (total book)	99.6% BTL
	0.4% Owner-Occupied

Source: Fitch, Paragon

Current Staffing

Total number of origination employees	160
Total number of servicing employees	135
Average industry experience (senior management)	15+

Source: Fitch, Paragon

Lending Criteria

Loan	BTL
Maximum LTV (%)	80.0%
Interest only	Yes
Maximum term	25 years
Adverse credit history	
Prior mortgage arrears	Based on credit score, would not normally consider application with prior adverse credit
CCJ (last 36 months)	Not allowed
Last bankruptcy/individual voluntary arrangement	Not allowed
Defaults (last 24 months)	Not allowed
Credit bureau used	Equifax and Experian
Income	
Affordability assessment	Full assessment (minimum income requirement of GBP25,000)
Affordability stress rate	Higher of pay rate + 2.0% or 5.5%[a]
% Regular overtime/bonus as income	0.0%
Self-employed	Yes
Self-certified	No
Affordability threshold	125% - 140% at higher of pay rate or stress rate
Property	
Type of property	Standard
Valuation	Full physical valuation
Lien	First
New build	Yes

[a] For 5-year fixed rate mortgages, the higher of pay rate and 4.0%
Source: Fitch

Company Overview

Paragon Bank is a subsidiary of the Paragon Banking Group plc (BBB/Stable/F3), which provides various financial products to consumers. Paragon specialises in the origination of buy-to-let (BTL) products and has originated since 1994. Since February 2001, the vast majority of originations have been to professional landlords. It should be noted that Paragon's definition of a professional landlord is somebody who owns four or more BTL properties.

Paragon has in excess of 66,000 BTL mortgages on its books, with a total outstanding balance of GBP9.84 billion as at 30 September 2017 (2016: GBP9.62 billion). The group's new BTL lending increased by 20.6% yoy 2016 to 2017. The book is distributed across England and Wales with 59% of loans located in the South East and London. Paragon has 15 outstanding RMBS, for GBP5.14 billion in issuance.

Paragon also originates second-charge loans and has recently entered the owner-occupied space with a small pilot scheme. Neither second-charge nor owner-occupied loans are included in this transaction.

Sourcing/Acquisition of Assets

Distribution is predominantly through the intermediary network with a very small balance of business coming via direct applications. Paragon maintains the network by using a dedicated sales force that is organised by geographic area and also ensures they have appropriate regulatory permissions.

All potential new intermediaries are required to submit their application to join Paragon's panel. Once submitted Paragon will check their FCA registration and permissions whilst also completing financial crime checks and searching for any FCA disciplinaries. Paragon's financial crime team will undertake broker reviews if intelligence or suspect applications are received. The relevant business areas are responsible for monitoring intermediaries in terms of arrears cases.

Underwriting

The underwriting unit is split into three teams, Portfolio (24 staff members), Non-Portfolio (7) and Underwriting Support (9).

All applications are reviewed by an underwriter prior to being run through the automated decisioning system to obtain a score. The score given dictates the level of further information required in order to fully underwrite the application. 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. The ICR is calculated within the system for non-portfolio BTL cases. 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 on to an appropriate mandate holder to do so.

Portfolio lending sees a more thorough underwriting process, with the underwriter reviewing extensive information about the applicant, his/her financial affairs and the property portfolio in question. It results in an extensive rationale for recommendation.

Loan Underwriter/Broker Incentive Scheme

Paragon underwriters are not incentivised by volume of applications reviewed or accepted. Intermediaries receive a procuration fee for each completed mortgage application (50bp) – this being a market standard.

Authorisation Levels

A mandate structure is in place that is appropriate for the business received. The decision to grant an underwriting mandate is delegated by the Group Credit Committee through the Director of First Mortgages to the Risk Management Team. Staffs are assessed for suitability and competency before either a new mandate or increased mandate is sanctioned. Mandates are published for record and the mandate limits are programmed into the origination system, which ensures that only those with specific authority may authorise a loan advance. Every new underwriter will go through a three-month training plan with a view to obtaining a mandate within three to six months.

Mandate Structure

Mandate level	Maximum loan portfolio (GBP)	Maximum LTV (%) portfolio	Maximum loan non-portfolio (GBP)	Maximum LTV (%) non-portfolio	Maximum group exposure (GBP)
1	CCQ	CCQ	CCQ	CCQ	CCQ
2	2,000,000	75	1,000,000	80	5,000,000
3	500,000	75	500,000	80	2,000,000
4	300,000	75	300,000	80	1,000,000
5	200,000	75	200,000	80	750,000
6	100,000	75	100,000	80	250,000

Source: Fitch

Fraud Prevention

Paragon use a variety of industry standard fraud prevention tools including 'Detect' (provided by Experian), CIFAS, National Hunter and SIRA. Paragon’s in-house fraud team of 14 staff is responsible for working referrals on a timely basis.

Quality Control and Audits

Quality control is carried out by a separate team as part of the securitisation quality process. Any matters that arise are referred back to the underwriters and a report is also sent to the relevant manager. The underwriting process is reviewed using a structured checklist assessment. This assessment is used to identify training needs. The quality review results are presented to senior management on a monthly basis.

Valuations

Full security assessments and valuation reports are required for each loan. The valuation must be conducted by either a Paragon employed surveyor or a member of Paragon's panel of surveyors. Paragon employs 27 surveyors, who are responsible for around 60% of Paragon’s valuations. The valuation always includes anticipated achievable rent and comparable rentals should also be supplied with the valuation report. Valuers should endeavor to obtain a minimum of one non-Paragon mortgaged property to be used for comparison purposes.

All valuations completed by panel valuers are audited.

Paragon does not utilise an Automated Valuation Model.

Valuation reports are valid for 3 months. If the valuation is older than 3 months then a Paragon surveyor has the ability to review the valuation and if appropriate extend it to a maximum of 3 months. If the valuation is =>5 months old and has not been reviewed then a re-inspection must be carried out.

Servicing

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

The servicing department is split into three teams:

Securities: responsible for deeds administration, mainly ensuring paragon’s charge is registered correctly

Customer Services: completing typical loan administration duties, this team is made up of 25 FTE. The team is also responsible for pre-delinquency contact when considered appropriate

Collections: Collections is split into three further teams: telephone, portfolio management and recoveries. The telephone team have responsibility for initiating telephone and letter contact with borrowers who have missed payments and making arrangements to clear arrears. The portfolio team consists of more experienced staff who works on more problematic and larger borrowings – typically of greater than GBP1 million where more than five properties are involved. The recoveries team is responsible for assessing third-party recovery claims and dealing with insolvent borrowers.

Receiver of Rent

If the borrower is two months in arrears then Paragon will appoint a receiver of rent (ROR) on the entire portfolio of the borrower. No court approval is required for this. Paragon use a wholly owned subsidiary called Redbrick Survey and Valuation Limited for the ROR process. Paragon will send a surveyor with a property agent to the property and inform the tenant that they have to pay their rent directly to Redbrick. No monies from that point on are paid to the borrower. The rent received by the ROR is used to pay the mortgage, arrears and associated fees, and a small percentage is also taken as a fee. Once the loan has become current again any monies received in excess to the monthly instalment are used to paydown the mortgage. The ROR will review a property that is under their control each quarter to decide whether to continue letting the property or whether 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 fits according to criteria once re-underwritten. Around one-third of the properties are sold and the other third are in churn.

Appendix B: Transaction Overview

Capital Structure

Class	Expected Ratings	Expected Outlook	Size (%)	CE[a] (%)	Interest Rate (%)	PMT freq.	Final maturity	TT[b] (%)	TTLM[c] (%)	ISIN
A	AAAsf	Stable	85.0	15.1	Libor + TBD	Quarterly	February 2050	85.0	20.0	XS1785818649
B	AAsf	Stable	4.75	10.4	Libor + TBD	Quarterly	February 2050	4.75	1.1	XS1785821437
C	A-sf	Stable	4.25	6.1	Libor + TBD	Quarterly	February 2050	4.25	1.0	XS1785821940
D	BBB-sf	Stable	3.50	2.6	Libor + TBD	Quarterly	February 2050	3.50	0.8	XS1785822088
Z	n.a.	n.a.	2.50	0.0	Libor + TBD	Quarterly	February 2050	2.50	0.6	XS1785822245
S	n.a.	n.a.	TBD	0.0	Libor + TBD	Quarterly	February 2050	TBD	n.a.	XS1785822328
S VFN	n.a.	n.a.	TBD	0.0	Libor + TBD	Quarterly	February 2050	TBD	n.a.	n.a.

[a] Credit Enhancement (CE): Consists of based on a total asset pool of GBP760.8m and the credit part of the amortising general reserve of 0.1% of the initial portfolio balance
[b] Tranche thickness percentage - ratio of class size to collateral balance
[c] Tranche thickness loss multiple - TT% divided by Fitch's base case loss expectation. See also *Structured Finance Tranche Thickness Metrics*
Source: Fitch, transaction documents

Key Information

Details		Parties	
Closing date	[April 2018]	**Sellers**	Paragon Mortgages (2010) Limited, Paragon Bank PLC
Country of assets and type	UK BTL RMBS	**Originators**	Paragon Mortgages (2010) Limited, Paragon Bank PLC
Country of SPV	UK	**Administrators**	Paragon Mortgages (2010) Limited, Paragon Bank PLC
Analysts	Henrik Nilsson	**Substitute administrator**	HML
	Haider Sarwar	**Issuer**	Paragon Mortgages (No.25) PLC
		Account bank	Citibank, N.A., London Branch
		Collection accounts	Barclays Bank PLC, NatWest Bank plc

Source: Fitch

Key Rating Drivers

- **Prime BTL Originations:** Paragon is an experienced lender specialising in the BTL segment with a large proportion of originations to professional landlords with four or more properties. Paragon originates in line with the guidelines introduced by the Prudential Regulation Authority (PRA) and Fitch views Paragon's underwriting standards to be in line with its expectations for a prime BTL lender.
- **Revolving Transaction:** A five-year revolving period, of which the first year is fully revolving, allows new assets to be added to the portfolio. While the replenishment criteria help mitigate risks about the potential migration of the portfolio's credit profile, the risk of some deterioration during the revolving period remains. Fitch assumed changes to the portfolio characteristics, giving credit to the replenishment criteria listed in the transaction documentation where relevant.
- **Class A Scheduled Amortisation:** Principal on the class A notes will be paid in the first instance according to a target scheduled amortisation starting after the first year. In the event that principal collections are not enough to meet the target scheduled amortisation, the amounts will be carried forward.
- **Hedging Mismatch:** Fitch sees there is a high probability the transaction will become over hedged due to defaults or prepayment, which is negative for the transaction in Fitch's stable and decreasing interest rate scenarios. This is because the initial hedging, and any further hedging required, is based on a 0% CPR notional. Fitch tested this as part of its cash flow modelling with the approach described further under the section *Hedging and Interest Rate Risk* in this report.

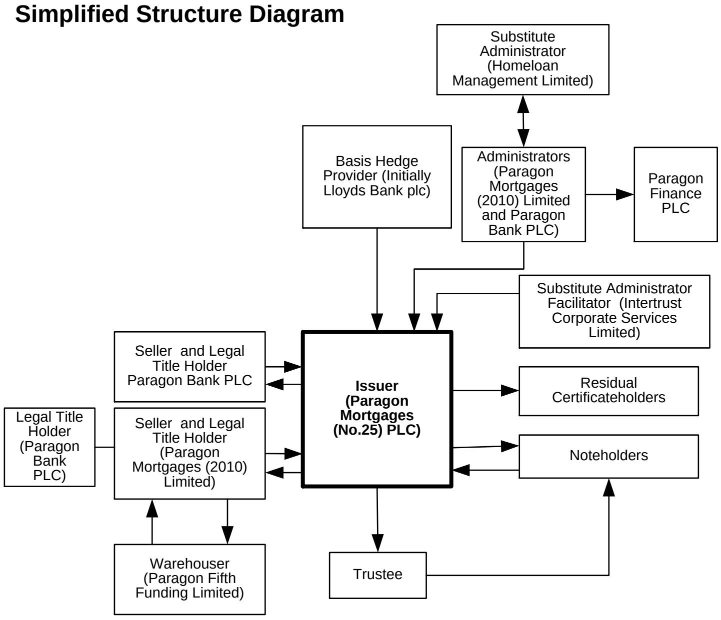
Source: Fitch

Fitch Default Model Output

Rating level	AAA	AA	A	BBB	BB	B
WAFF (%)	22.7	18.5	13.9	9.7	6.1	4.2
WARR (%)	39.8	44.2	48.6	53.0	57.3	61.5
WALS (%)	75.4	71.0	64.4	60.1	53.6	49.3
WAMVD (%)	70.5	67.4	64.2	61.0	57.9	54.7

Source: Fitch

Simplified Structure Diagram



Source: Fitch, Transaction document

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.