MOODY'S
INVESTORS SERVICE

CREDIT OPINION
26 April 2018

New Issue

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Closing Date
[•] April 2018

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Paragon Mortgages (No.25) PLC

New Issue - Paragon Mortgages Group issues 25th Paragon Mortgages UK buy-to-let RMBS

Capital structure

Exhibit 1
Definitive (D) ratings

Series	Rating	Amount (Million)	% Of Assets	Legal Final Maturity	Coupon*	Subordi-nation**	Reserve Fund ***	Total Credit Enhance-ment****
Class A	Aaa (sf)	£600.0m	85.00%	May-2050	3m£L+ 65 bps	15.00%	1.50%	16.50%
Class B	Aa1 (sf)	£33.5m	4.75%	May-2050	3m£L+ 95 bps	10.25%	1.50%	11.75%
Class C	A1 (sf)	£30.0m	4.25%	May-2050	3m£L+ 130 bps	6.00%	1.50%	7.50%
Class D	Baa1 (sf)	£24.7m	3.50%	May-2050	3m£L+ 160 bps	2.50%	1.50%	4.00%
Class Z	NR	£17.7m	2.50%	May-2050	3m£L+ 260 bps	0.00%	0.00%	0.00%
Class S	NR	£10.9m	N/A	May-2050	3m£L+ 400 bps	0.00%	0.00%	0.00%
Class S VFN	NR	£7.9m	N/A	May-2050	3m£L+ 400 bps	0.00%	0.00%	0.00%
Class RC1a & RC1b	NR		N/A	May-2050	N/A	0.00%	0.00%	0.00%
Class RC1a & RC1b	NR		N/A	May-2050	N/A	0.00%	0.00%	0.00%
Total		£724.7m	100.00%					

The ratings address the expected loss posed to investors by the legal final maturity date. Our ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors. * On the interest payment date falling in May 2023, the margin payable on Class A to D notes will increase. Interest payable on Class B, C, D and Z notes is deferrable with interest accruing on deferred payments at a rate equal to 3-month GBP Libor plus the relevant margin shown in the table above as long as such notes are not the most senior outstanding class of notes. ** Subordination is as a % of the asset pool at closing. Classes S, S VFN, RC1a/b and RC2a/b are not backed by collateral. *** The reserve fund is as a % of the A, B, C and D notes. It is amortising with no floor. **** Does not include the benefit of excess spread. *****Class A to Z sums to 100%.
Source: Moody's Investors Service

Summary

This transaction is a substituting securitisation of buy-to-let mortgage loans extended to borrowers in the UK. This is the 30th securitisation that we have rated from Paragon. It is backed exclusively by buy-to-let mortgage loans originated by members of the Paragon Banking Group ("Paragon").

As of the cut-off date of 17 April 2018, the definitive portfolio consisted of loans secured by mortgages on residential properties in the UK extended to 3,415 borrowers for buy to let purposes. Before substitution the pool balance was circa £705.2 million.

Credit strengths

The following factors were the strongest features of this transaction:

» ***Asset quality***: Particular strengths include:

- *No prior adverse credit:* None of the borrowers in the securitised pool has been subject to any personal bankruptcy, individual voluntary arrangements or country court judgments. (see Asset analysis – Comparables)
- *Ongoing Agreed Upon Procedure* ("AUP"): The provisional portfolio was subject to an AUP. The definitive portfolio was a subset of the initial portfolio. Subsequent portfolios exceeding 30% of the original pool size, as well as the final tranche of loans to be sold to the issuer by the step-up date will also be subject to an AUP. (see Asset analysis – Comparables)
- *Originator's long origination history*: The originator has provided historical information since 1996 and has an extensive track record of operating in its market segment. Analysis shows that the performance of its securitisations has been better than the average in the UK buy-to-let sector. (see Asset analysis – Comparables)
- *Weighted average (WA) loan-to-value (LTV) ratio*: The pool has a current weighted average LTV ratio of 70.3%, with no loans with WA LTV ratios higher than 90%. About 4.5% of the pool has WA LTV ratios between 80% and 90%, a proportion that compares favourably with that of peer transactions. (see Asset analysis – Comparables)
- *Property valuations*: At origination, a surveyor has performed a full valuation of the property and has included three comparables in the valuation report. Desktop valuations or valuations produced using an automated valuation model are used to check the full valuation provided by the surveyor. (see Asset analysis – Comparables)

» ***Structure*:**

- *Two amortising reserve funds*: The deal benefits from two amortising reserve funds sized on aggregate at closing at 1.5% of the rated notes. One reserve fund equals 1.5% of Class A and Class B notes' outstanding principal amount and is dedicated solely to provide liquidity to Class A and Class B notes, and cover senior expenses. The other reserve fund is available for all the rated notes and senior expenses. The reserve funds will amortise sequentially except if there has been a required amount trigger.(see Detailed description of the transaction – Reserve Fund).
- *Protection of yield through swap:* Around 81.4% of the pool consists of fixed-rate loans, which will reset to 3-month GBP Libor plus a margin or the seller's Standard Variable Rate (SVR). The fixed-floating mismatch between these assets and the notes is mitigated by fixed-floating swaps, which will adjust through the revolving period to cover the fixed-floating mismatch and are provided by Lloyds Bank Plc (Aa3/P-1/Aa3(cr)/P-1(cr)).

Credit challenges

The transaction contains the following challenges:

» ***Revolving period increases the risk of losses*****:** Subject to certain conditions being satisfied, the structure allows additional loans to be added up until the step-up date. Substitution takes place as long as the scheduled payments on Class A are first met, limiting the total amount of substitution possible. Substitution potentially introduces additional risks through the following:

– Asset-quality drift compared with that at close, including the benefit of previous house price increases and the seasoning of the current assets escaping the transaction (see Asset analysis – Comparables).

– Incremental losses, which could be generated from the new loans, as well as the original pool at close (see Asset analysis – Comparables).

– Loans that are added are not required to be fully performing; loans with arrears can be included subject to certain limits (see Asset analysis – Comparables).

» ***Risk of margin compression:*** The conditions to substitute only require that the WA pool margin post-substitution equals 3-month GBP Libor plus 3% (after taking into account any hedging and the benefit of any margin reserve) (see Primary Structural Analysis - Spread Compression)

» ***Affordability of mortgage payments***: About 92.1% of loans have been advanced on an interest-only (IO) basis. The risk that IO borrowers could have more stretched finances and the result of FCA's mortgage market review could limit refinancing opportunities for such borrowers (see Asset analysis – Comparables)

» ***Servicing disruption risk***:

– The servicers/cash administrators are not rated by us. The transaction is therefore exposed to financial disruption risks (see Asset description - Originator and servicer).

– This risk is mitigated by the fact that there is a backup servicer/cash manager, Homeloan Management Limited, appointed at closing (see Asset description - Originator and servicer).

– Furthermore, the backup servicing facilitator, Intertrust Management Limited (not rated), undertakes to facilitate the search for a suitable backup servicer/administrator in case either the original servicer or the original administrator is terminated from its role (see Asset description - Originator and servicer).

» ***Receiver of rent***:

– Paragon Banking Group uses a receiver of rent as a means of controlling arrears and losses. (see Detailed description of the transaction - Receiver of rent)

– We believe that should the house prices weaken significantly, it could lead to an increase in loss severities. In a severe recession, a receiver of rent may be unable to successfully re-let a vacant property and so repossession would occur in any case but with a lag and an increased loss severity. (see Detailed description of the transaction - Receiver of rent)

– Additionally, excess spread can leak out of the transaction instead of covering losses and amortising the notes down, as in the case of repossession. Finally, this is an operationally more complex method of resolving payment problems compared with attempting to foreclose sooner, which could be compounded in cases where the servicer itself is under financial pressure. (see Detailed description of the transaction - Receiver of rent)

– Our MILAN CE and expected loss assumptions take the use of the receiver of rent into account. (see Detailed description of the transaction - Receiver of rent)

Key characteristics

Exhibit 2
Asset characteristics
(Definitive pool, cut-off date of 17 April 2018)

Issuer	Paragon Mortgages (No.25) PLC
Seller:	Paragon Mortgages 2010 Limited ("PML") and Paragon Bank Plc ("PB"), wholly owned subsidiaries of Paragon Banking Group ("Paragon") (both not rated)
Originators:	Paragon Mortgages 2010 Limited ("PML") and Paragon Bank Plc ("PB"), wholly owned subsidiaries of Paragon Banking Group ("Paragon") (both not rated)
Servicers and legal title holders:	PML and PB
Receivables:	First-lien (or first and second lien) buy-to-let loans to individuals secured by property located in the UK
Methodology Used:	Moody's Approach to Rating RMBS Using the MILAN Framework, September 2017 (1039709)
Total Amount:	£705.3 million, subject to replenishment following a target amortisation profile
Number of Borrowers:	3,415
Borrower concentration:	Top 20 borrowers make up 4.57%
WA Remaining Term:	18.96 years
WA Seasoning:	2.42 years
Interest Basis:	18.6% linked to 3m LIBOR, 81.4% fixed rate loans reverting to 3m LIBOR (33.7%) or SVR (46.6%)SVR
WA Current LTV:	70.28%
WA Original LTV:	70.86%
Moody's calculated WA indexed LTV:	66.21%
Borrower credit profile:	Prime borrowers
Delinquency Status:	0.00% in arrears more 90 days

Source: Moody's Investors Service

Securitisation structure characteristics

Exhibit 3
Structure summary

Issuer:	Paragon Mortgages (No.25) PLC
Issuer Administrator / Corporate Service Provider:	Intertrust Corporate Services Ltd (Not Rated)
Models Used:	MILAN (UK Settings), ABSROM
Excess Spread at Closing:	1.33% at closing (not stressed)
Length of Revolving Period:	5 years
Back-up Servicer(s):	Each servicer agrees to act for the other servicer in case of servicing interruption. Furthermore Homeloan Management Limited ("HML") is the back-up servicer.
Back-up Servicer Facilitator:	Intertrust Corporate Services Ltd (Not Rated)
Cash Manager:	Paragon Mortgages (2010) Limited (Not Rated)
Back-up Cash Manager:	Homeloan Management Limited (Not Rated)
Principal Paying Agent:	Citibank, N.A., London Branch (A1/(P)P-1/A1(cr)/P-1(cr))
Back-up Calculation/Computational Agent:	N/A
Issuer Account Bank:	Citibank, N.A., London Branch (A1/(P)P-1/A1(cr)/P-1(cr))
Collection Account Banks:	Barclays Bank PLC (A1/P-1/A1(cr)/P-1(cr)) for Paragon Mortgages (2010) Ltd; and NatWest Bank PLC (A2/P-1/Aa3(cr)/P-1(cr)) for Paragon Bank plc
Trustee:	Citicorp Trustee Company Limited (NR)
Arrangers:	Lloyds Bank Plc (Aa3/P-1/Aa3(cr)/P-1(cr)) and Morgan Stanley & Co International (A1/P-1)
Swap Provider:	Lloyds Bank Plc (Aa3/P-1/Aa3(cr)/P-1(cr))
Credit Enhancements/Reserves:	At closing the two reserve funds will be funded with the proceeds of the Class S notes. The Class A and Class B Liquidity Reserve initially is funded to 1.5% of Classes A and B. The General Reserve is funded to 1.5 % of Class C and D notes. Both reserve funds are sequentially amortising.
Form of Liquidity:	The Class A and Class B Liquidity Reserve (solely for Class A and Class B notes interest; senior fees, excluding PDL); The General Reserve (for all notes, and senior fees, excluding PDL); principal to pay interest (only for A and B notes).
Number of Interest Payments Covered by Liquidity:	The cash reserves amount provide around 3 months of liquidity assuming a LIBOR rate of 5.7%
Interest Payments:	Quarterly in arrears on each payment date
Principal Payments:	The Class A notes follow a scheduled amortisation profile until the step-up date; until then the B, C, D and Z notes are not expected to amortise. Following the step up date, pass-through according to principal receipts in order of seniority.
Payment Dates:	15th of February, May, August and November
First Payment Date:	15th August 2018
Hedging Arrangements:	There is fixed-floating swap hedging for the fixed portion of the pool. The fixed/floating hedge will adjust to hedge the current fixed rate portion of the portfolio, with a tolerance margin of £10million above/below such balance.

Source: Moody's Investors Service

Asset description

The assets backing the notes are first-ranking (and second-ranking, however, only if the first-ranking loan is also included in the securitised portfolio) prime buy-to-let mortgage loans originated by the sellers under the trading name of Paragon Banking Group. All the loans in the pool are secured on residential properties in the UK; Exhibits 4-7 detail additional high-level information regarding the assets in the pool.

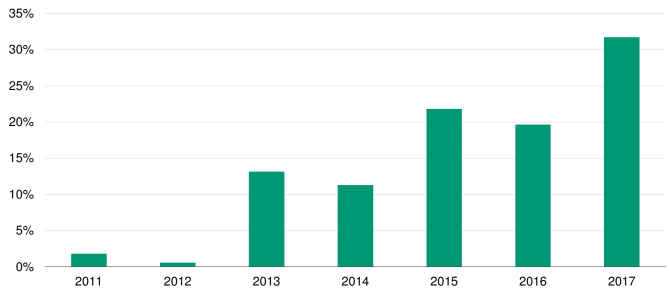
Asset description at the portfolio cut-off date

The definitive pool cut-off date is 17 April 2018.

Pool characteristics

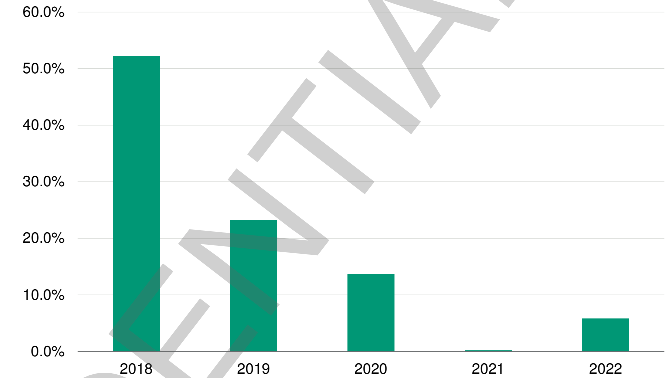
Exhibit 4 illustrates that about half of the loans in the pool (51.37%) were originated in 2016 and 2017, and 48.63% were originated before 2016. Exhibit 5 highlights the time when the fixed-rate portion of the portfolio will reset, with 52.22% of the fixed-rate mortgage loans in the pool switching to floating rate in 2018. The entire fixed portion of the pool will reset to floating rate on average in 2.12 years.

Exhibit 4
Portfolio breakdown by date of origination



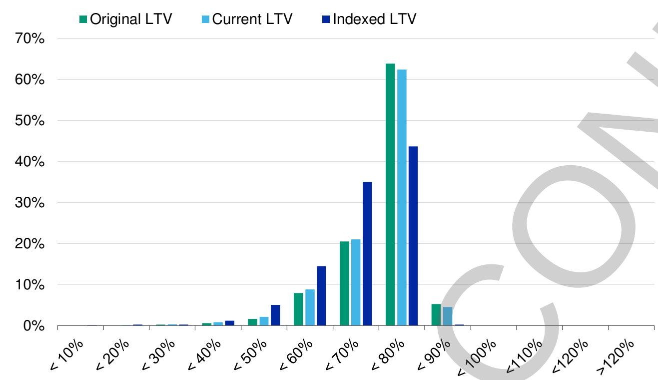
Sources: MILAN file by Paragon Banking Group computations by Moody's Investors Service

Exhibit 5
Fixed-rate portfolio breakdown by year of reset



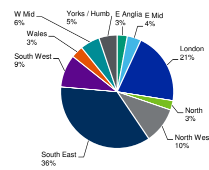
Sources: MILAN file by Paragon Banking Group, computations by Moody's Investors Service

Exhibit 6
Portfolio breakdown by current/indexed LTV ratio



Sources: MILAN file by Paragon Banking Group, computations by Moody's Investors Service

Exhibit 7
Portfolio breakdown by geography



Sources: MILAN file by Paragon Banking Group, computations by Moody's Investors Service

The WA LTV ratio of the pool is 70.28%, and Exhibit 6 shows that more than half of the pool has a current LTV ratio of 70%-80%. Around 35.80% of the loans are concentrated in the South East region, as Exhibit 7 shows, and 20.60% of the pool is concentrated in the London region. As is fairly common for this type of portfolios, there are some material borrower concentrations because the borrowers tend to have multiple properties. In this portfolio, the top 20 borrowers represent 4.57% of the pool.

Originator/servicer

The sellers, Paragon Bank Plc and Paragon Banking Group (2010) Ltd (PML), are part of the Paragon Banking Group (neither seller is rated). PML is an origination vehicle, established in 2008, while Paragon Bank Plc is a bank licensed to take deposits and provide finance including regulated consumer credit. Paragon Bank Plc is authorised and regulated by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"), and is the parent company of Paragon Banking Group (2010) Ltd.

All the loans securitised were originated under the branding of Paragon . Paragon Banking Group provides mostly buy-to-let to "professional" landlords, who are borrowers with portfolios of properties. As such, there is above average borrower concentration in the pool.

The sellers are also the servicers and cash administrators of the transaction, with PML taking the primary lead in both respects. They have agreed to take on each other's role in case of servicing disruption by the other party.

Further information regarding the servicer and originator, including our originator and servicer reviews, can be found in Appendix 3.

This is Paragon Group's 30th securitisation transaction to include buy-to-let loans.

Changes to the asset pool after issuance

The transaction is a revolving securitisation for five years after closing, and hence changes to the asset pool can occur after issuance that can affect the ongoing pool composition. We have analysed how pool quality and characteristics might drift over time. The asset characteristics need to remain within the permitted concentration limits and meet the eligibility criteria upon entry, as summarised below. Further advances and product switches are also permitted, subject to certain limitations, as described in more detail below.

Eligibility criteria

The sellers provide the seller asset warranties, which if not met, mean that the loans need to be repurchased. All loans upon entry to the portfolio, either at the closing date or at the subsequent purchase dates, must meet the following asset acquisition guidelines (*inter alia*):

» Each loan constitutes a valid and binding obligation of the borrower, and

- is a first legal charge over the property
- both the first and second legal charges are in the same portfolio

» Properties are either residential or mixed residential/commercial use

» All steps to perfect legal title have been taken or are being taken, with no delay after origination

» Prior to granting initial loans or further advances, the sellers' lending guidelines were adhered to

» On each purchase date, loans with greater-than-one-month arrears did not exceed £1 million

» Each loan has a term ending no later than [April 2048

» The property securing the mortgage(s) is in England or Wales

» No borrower is an employee or director of Paragon

» At least one monthly instalment due in respect of each loan has been paid by the relevant borrower

» Each loan was, at the time of origination and continues to be denominated, in sterling

» Before making an initial mortgage loan, a valuation is made either by a valuation by the seller's valuer or a valuer appointed on the seller's behalf. Further advances may be made using indexed valuations

Conditions for substitution

During the substitution period, the following conditions must be satisfied (*inter alia*) to sell additional loans to the issuer or before making mandatory or discretionary further advances:

» The substitution date is before or on the step-up date (for avoidance of doubt, this condition does not apply for the purchase of further advances).

» The loans are not in breach of any of the seller asset warranties mentioned above.

» The WA current LTV ratio of all loans does not exceed 75%.

» The WA interest rate applicable to the current balance of all loans, after taking into account any applicable reserves allowed for the purpose of topping up the yield, is not less than 3-month GBP Libor plus 3.00%.

» The amount standing to the credit of the mandatory further advance pre-funding reserve ledger or the principal ledger is sufficient to cover mandatory further advances.

» The administrator ensures that the fixed-rate loans are hedged within 30 days of the sale date.

» The hedging corridor of under/over-hedging (£10,000,000) has been met.

» The aggregate balance of loans with a current LTV ratio (including fees) of more than 77% does not exceed 15%.

» The maximum London concentration is 40%.

» The maximum South East concentration is 40%.

» The maximum regional concentration in any other area is 20%.

» The WA rental cover (as per Paragon's calculations, which may vary from loan to loan) is not less than 145%.

» The maximum remaining fixed period is not more than 5.5 years.

» The amount standing to the credit of the principal ledger on such date is enough to amortise the Class A notes to their targeted amortisation schedule.

» Any additional loans are not in arrears by more than a month.

» Paragon Banking Group owns at least 50% of the residual certificates.

» There was no principal deficiency ledger (PDL) at the previous interest payment date on the notes.

Stop substitution conditions

Substitution ceases for good as soon of as any of the conditions below are met:

» An event of default in relation to the issuer

» An insolvency event in relation to either seller

» An unremedied breach by either seller of any of their respective obligations per the transaction documents

» If the aggregated amount that has been debited to the PDL entry since the closing date is greater than 1% of the aggregate initial principal amount outstanding of all Class A-Z notes

» If the rated notes' reserve fund is less than the target amount

» If Class A and Class B liquidity reserve fund is less than the target amount

» If the aggregate balance of loans, which is in arrears by more than three months, or where the loan has had three missed payments (whether capitalised or not) is greater than 3%

Furthermore, substitution shall only continue as long as the Class A note balance is met. For example, if there are fewer portfolio redemptions than needed to reach the target Class A note balance, then all amortisation would go towards repaying the Class A notes.

Only excess redemptions would be used to purchase new loans. The issuer has the ability to store 5% of the original pool balance in cash via the retained principal ledger, while it awaits new loans to be purchased.

For avoidance of doubt, non-payment of the Class A scheduled amortisation amounts does not constitute a note event of default, although non-payment of the most senior class outstanding interest would cause an issuer event of default.

Loan amendments

Amendments of loans in the pool are possible only in relation to interest rate conversions (to change the basis upon which the interest rate is charged) and repayment terms (to change from IO or part to repayment only).

Interest rate conversions are subject to the following limits:

» No unremedied event of default has occurred at the time of the proposed conversion.

» There are no other material terms to the mortgage documentation.

» Where the loan is to be converted to a fixed-rate loan, the administrator will within 30 days enter into a fixed-floating hedge and the WA swap rate does not exceed 4%.

» The hedging corridor of under/over-hedging (£10,000,000) has been met.

» The borrower under such loan is not more than a month in arrears.

» The conversion takes place on or before the step-up date.

» The conversion margin reserve fund has sufficient funds to ensure that the issuers' available revenue receipts are not reduced by the conversion.

» No administrator termination event has taken place.

PML, as the administrator, may also on each interest payment date debit the revenue ledger and credit a discretionary further advances reserve (the "conversion MRF discretionary fund") to fund the amounts required for future conversions. Such amounts can be used, *inter alia*, to ensure that the effect of the conversion is that the issuer does not receive less revenue receipts in respect of such interest rate conversions.

Repayment conversions are permitted too, subject to an aggregate cap of 10% of the mortgage portfolio.

Further advances

Certain loans in the pool have mandatory further advances, for example, loans where the properties are undergoing repair or renovation works. Other loans may be granted discretionary further advances. Mandatory further advances are granted at any time and funded first from the mandatory further advances prefunding the reserve ledger and then from the issuer's own principal receipts. Following the end of the substitution period, the issuer will have reserved for all known mandatory further advances. Discretionary further advances can only be granted subject to certain conditions, among others, that the issuer is able to reach the target Class A amortisation schedule.

Asset analysis

Primary asset analysis

The first step in the analysis of the credit quality of the pool is to determine a loss distribution of the mortgages to be securitised. To determine the shape of the curve, two parameters are needed: the expected loss and the volatility around this expected loss. These parameters are derived from two important sources: historical loss data and the MILAN loan-by-loan model.

Expected loss

We use performance data provided by the originator in addition to other relevant data to extrapolate expected losses for the loan pool. Examples of data include market- and sector-wide performance data, the performance of other securitisations and other originators' data.

The expected loss of 1.25% for this transaction was obtained by benchmarking it with other securitisations of buy-to-let mortgages originated by UK mortgage originators, and taking into account the buy-to-let nature of the mortgages and the experience of Paragon in the buy-to-let sector.

The expected loss for this transaction is in line with set due to (1) the revolving structure of the transaction and the consequent potential asset deterioration, (2) around 92.10% of the pool being IO loans, and (3) benchmarking with other UK buy-to-let transactions.

MILAN model

To obtain the volatility under stressed scenarios, we take into account historical data. However, historical volatility may not be significant (given insufficient data points or incomplete data), and in addition, may not be representative of the future because it is based on the previous economic environments experienced.

Consequently, we determine a number representing the enhancement that would be required for a pool of mortgages to obtain a rating consistent with Aaa under highly stressed conditions. This enhancement number (the MILAN CE number) is produced by using a loan-by-loan model, which looks at each loan in the pool individually, and based on its individual characteristics such as the LTV ratio or other identified drivers of risk, will produce a benchmark CE number. This assumes stressed recovery rates (through house price decline), time to recovery, interest rates and costs to foreclosure. The WA benchmark CE number will then be adjusted according to positive and negative characteristics of each loan or of the pool as a whole to produce the MILAN CE number.

The MILAN CE for this pool is 14.5%, which is higher than that of other comparable buy-to-let transactions in the UK mainly because of (1) the revolving structure of the transaction, (2) a WA current LTV ratio of 70.28%, (2) the fact that around 92.10% of the pool are IO loans, and (3) benchmarking with other UK buy-to-let transactions.

Lognormal distribution

The MILAN CE number and the expected loss number are based on Rating Committee discussions and are used to derive the lognormal distribution of the pool losses. Because of the large number of loans and supporting historical data, we use a continuous distribution to approximate the loss distribution.

The standard deviation of the distribution is found by setting the expected loss of the area of the lognormal distribution beyond the MILAN CE equal to the expected loss that is consistent with the idealised expected loss of a Aaa tranche.

Risk of yield compression

The pool currently comprises a mix of fixed-rate loans and loans tied to 3-month GBP Libor. All fixed-rate loans roll off onto either Paragon's SVR rate or onto 3-month GBP Libor plus a margin within two to five years after origination.

The 3-month GBP Libor used by Paragon differs in terms of reset date from the 3-month GBP Libor used for the notes. There can be differences in values if the same index has different reset dates. There is no hedging against this risk, so we assessed the probable mismatch and incorporated it into the yield vector used for the transaction.

Paragon's SVR is not explicitly tied to Libor, although over the past five years, it has maintained a margin of at least 4% above 3-month GBP Libor . Because of a lack of an explicit covenant by Paragon to maintain its SVR above a certain level, we have also built into our yield assessment of the portfolio an assumed compression in the yield of the SVR-linked loans.

The fixed-floating risk between the fixed-rate loans and the 3-month GBP Libor due under the notes is hedged via a series of swaps with Lloyds Bank Plc (Aa3/P-1/Aa3(cr)/P-1(cr)). The swaps will be adjusted to allow for substituted loans entering the pool or loans with product switches, also fixed rate, such that the swap notional will adjust to hedge the current outstanding balance of such loans, but only subject to a tolerance of £10 million either above or below that amount. Furthermore, there is up to a one-month time lag between when the swap takes effect and after the loans have entered the pool.

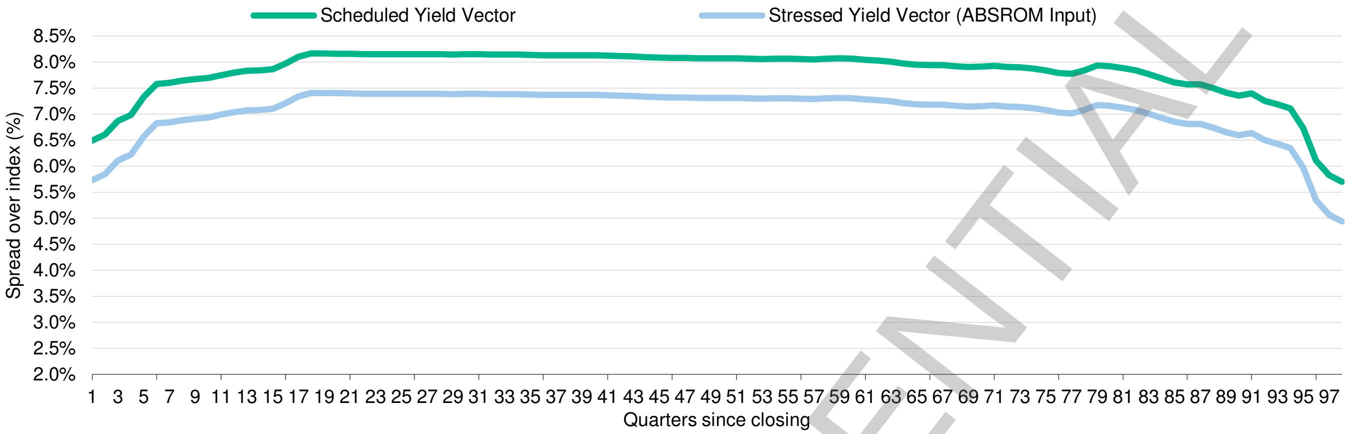
Although the presence of the swap mitigates the majority of the mismatch, the time lag and tolerance built into the swap mean that there could still be some yield compression because of the fixed-rate portion of the portfolio.

A further source of spread compression can arise if higher-yielding loans prepay faster than lower-yielding loans, which could lead to a decrease in the average yield on the whole pool of loans during the life of the transaction.

Exhibit 8 shows the yield vector used by us in the analysis of the transaction, considering just the prepayment effect referred to above, and assuming 0.6% 3-month GBP Libor through the term of the transaction. Further stresses to the yield were applied in our base case modelling, for instance, to do with the potential reduction in the SVR due to no minimum SVR rate covenant, because of unhedged Libor/Libor-resetting risk, and because of the potential for the notes to be slightly underhedged owing to the £10 million hedging corridor.

Exhibit 8

Scheduled yield vector versus spread-compressed yield vector used by Moody's



Source: Paragon Banking Group provided the MILAN file, computation by Moody's

Comparables

Exhibit 9

Benchmark table with other transactions by the same originator and comparable transactions

Deal Name	Paragon Mortgages No.25	Paragon Mortgages (No. 24) PLC	Paragon Mortgages (No. 23) PLC	Precise Mortgage 2018-2 PLC	Precise Mortgage 2018-1 PLC	Precise Mortgage 2017-1 PLC	London Wall Mortgage Capital Series Fleet 2017-01	Malt Hill No. 1 plc	Offa No. 1 plc
Pool Data	Definitive pool as of 17 Apr 2018	Closing pool	Closing pool	Provisional pool	Closing pool	Closing pool	Final Pool	Closing pool	Closing pool
Closing date	Apr-18	Nov-18	Jul-18	Jan-18	Jan-17	Apr-17	Aug-17	May-16	1-Mar-16
Information from	Data provided by Paragon to Moody's	Data provided by Paragon to Moody's	Data provided by Paragon to Moody's	Data provided by CCFS to Moody's	Data provided by CCFS to Moody's	Data provided by CCFS to Moody's	Data provided by Fleet Mortgages to Moody's	Data provided by CBS to Moody's	Data provided by CBS to Moody's
Originator	Paragon	Paragon	Paragon	CCFS	CCFS	CCFS	Fleet Mortgages	Godiva Mortgages	Godiva Mortgages
Servicer	Paragon	Paragon	Paragon	CML	CML	CCFS	Fleet Mortgages	Coventry Building Society	Coventry Building Society
MILAN CE	14.50%	12.00%	12.00%	12%	12%	13%	13.00%	11%	9.00%
Expected Loss	1.25%	1.25%	1.25%	2.00%	2.00%	2.00%	2.20%	1.10%	0.90%
Avg. Current LTV	70.28%	72.50%	72.70%	71.04%	67.40%	72.00%	66.46%	64.90%	51.66%
% Current LTV > 70%	62.40%	77.70%	78.80%	69.17%	52.42%	74.41%	47.30%	34.80%	2.65%
% Current LTV > 80%	4.50%	12.30%	11.20%	12.03%	8.25%	7.78%	2.56%	0.00%	0.00%
% Current LTV > 90%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Avg. Current LTV indexed	66.21%	72.40%	72.60%	69.02%	64.99%	71.51%	65.39%	62.90%	41.82%
% Self Employed	57.90%	41.90%	43.40%	53.66%	52.85%	52.15%	35.01%	15.20%	31.25%
% Self Certified	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
% Non-owner Occupied (Includes: Partial Owner)	100%	100%	100%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
% IO without collateral	92.10%	93.30%	91.60%	89.46%	89.20%	95.35%	94.42%	0.872	77.24%
% Fixed interest	81.40%	89.20%	88.40%	66.60%	65.30%	44.80%	77.40%	100.00%	39.30%
Max regional concentration	South East (35.8)%	South East (40.1)%	South East (39.0)%	South East 26.70%	London and South-East (41.9%)	London and South-East (72.8%)	London (42.0%)	London and South-East (76.6%)	(South East) 33.95%
% CCJs	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
% IVA / Bankruptcy	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
% in arrears	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.40%	0.00%
Current Balance	£705.2	£348.5	£281.2	£ 399.1	£246.1	£300.0	£396.6	£301.1	£462.18
Average Borrower Exposure	£206,522	£186,638	£174,107	£175,746	£165,397	£281,955	£292,935	£177,656	£110,702
Borrower top 20 (as % of pool bal)	4.57%	5.80%	5.10%	6.41%	7.10%	8.34%	6.50%	3.60%	2.88%
WA interest rate	3.83%	3.80%	3.80%	3.68%	3.76%	3.85%	3.48%	3.36%	3.87%
Stabilised margin*						3.50%		SVR (4.74%)	SVR (4.74%)
Average seasoning in years	2.42	0.35	0.2	0.84	0.97	0.52	1.06	0.8	4.82
Average time to maturity in years	18.96	20.96	20.7	21.47	20.78	21.94	19.92	20	13.52
Maximum maturity date	Nov-42	Oct-40	Jul-40	Jan-53	Sep-52	Feb-52	Oct-46	Aug-50	Apr-47
Average House Price stress rate**	32.25%	33.40%	32.00%	31.35%	31.24%	33.98%	33.60%	34.40%	34.15%
Average House Price change	6.79%	0.20%	0.00%	3.07%	3.87%	0.76%	1.74%	3.20%	26.04%

Source: Moody's Investors Service

Sector outlook

We have a negative collateral performance outlook for the UK buy-to-let RMBS sector. However, the UK's low interest rates should continue to support RMBS performance.

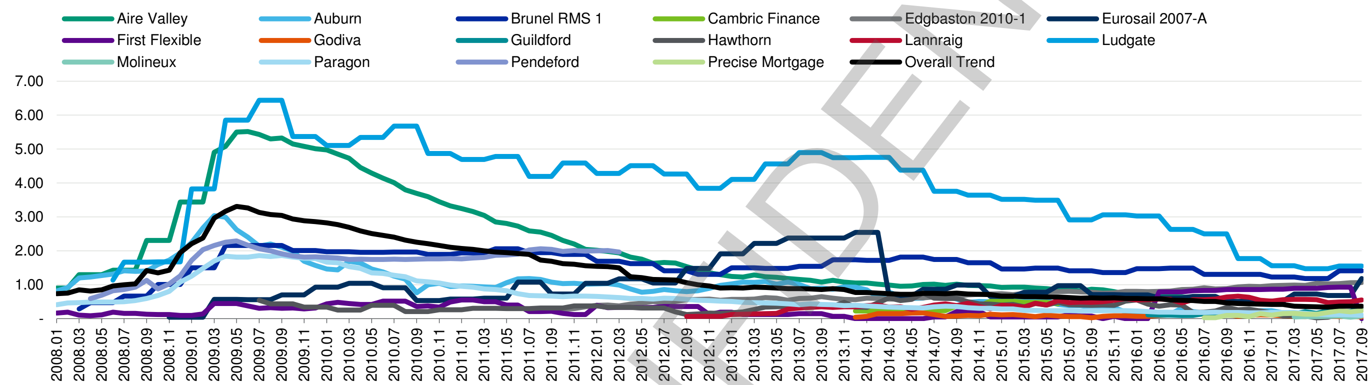
The drivers of the expected UK buy-to-let collateral performance are (1) rental income that will grow more slowly or even decline in some regions, and (2) the pressure on tenants' disposable income. Buy-to-let transactions with large exposures to recent vintage mortgages will be most affected.

We expect UK real GDP growth to slow to 1.3% in 2018 from 1.7% in 2017, before recovering to 1.6% in 2019. Brexit will continue to weigh on the nation's economic growth prospects, with significant downside risks to the domestic economy if the UK and the European Union do not reach an amicable deal.

Please see Exhibits 10 and 11 to understand how comparable deals in the sector have performed.

Exhibit 10

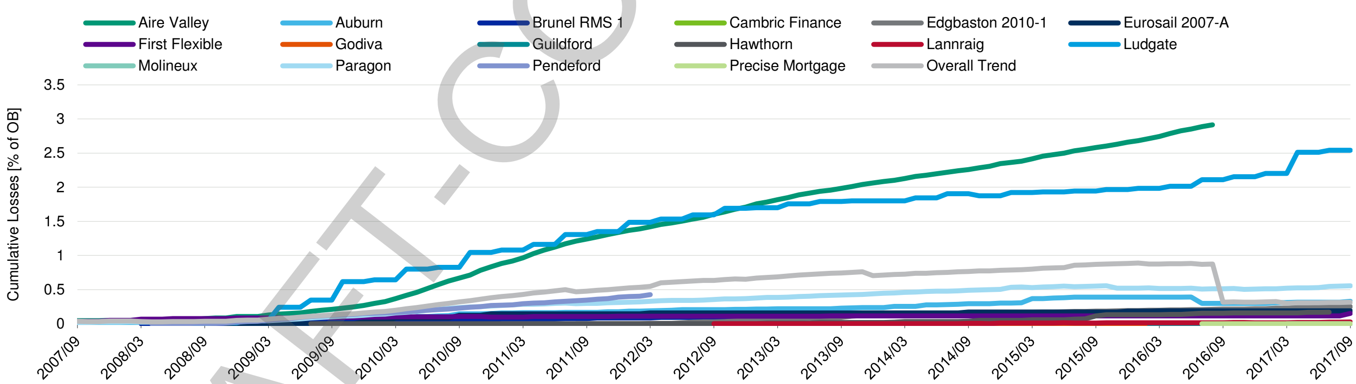
Buy-to-let RMBS - UK 90+ days delinquencyPercentage of current portfolio balance



Sources: Moody's Investors Service, periodic investor/servicer reports

Exhibit 11

Buy-to-let RMBS - UK cumulative losses



Numerator: Cumulative losses since closing date. Denominator: Original pool balance plus cumulative replenishments for standalone deals, and current pool balance plus cumulative additions for master trusts.
Sources: Moody's Investors Service, periodic investor/servicer reports

Additional analysis

Data quantity and content

In our view, the quantity and quality of data received is similar compared with those in transactions that have achieved high investment-grade ratings in this sector. An AUP was performed in [February 2018 . The AUP results were in line with our expectations and did not highlight any particular concerns regarding the quality of the data. Furthermore, AUP will be conducted whenever the cumulative balance of loans added to the pool reaches 30% of the original pool size, and at the step-up date. Such AUP results will be communicated to us.

Originator quality

We believe that Paragon Banking Group has adequate controls and procedures in place to generate high-quality loans, and according to our originator review, the overall origination ability and stability of Paragon has been classified as average. For more information, see Appendix 3, which contains the originator review.

Servicer quality

We have reviewed Paragon ' procedures and practices, and found Paragon acceptable in the role of servicer. According to our servicer review, the overall servicing ability and stability has been classified as average. For more information, see Appendix 3, which contains the servicer review.

Receiver of rent

The sellers/administrators use a receiver of rent as a means of controlling arrears and losses for third-party loans that they service and it could be used on the loans in this transaction.

Because of the low level of arrears in the favourable interest rate environment, this has yielded positive results to date, with precise performance metrics comparing favourably with the sector average.

We believe that should the house prices weaken significantly, it could lead to an increase in loss severities. In a severe recession, a receiver of rent may be unable to successfully re-let a vacant property and so repossession would occur in any case but with a lag and an increased loss severity. Additionally, excess spread can leak out of the transaction instead of covering losses and amortising the notes down, as in the case of repossession. Finally, this is an operationally more complex method of resolving payment problems compared with attempting to foreclose sooner, which could be compounded in cases where the servicer itself is under financial pressure. Our MILAN and expected loss numbers take the use of a receiver of rent into account.

Set-off

Some of the borrowers have an account with Paragon Bank Plc (PB); however, only a few have an account balance above £85,000, which is the limit above which the UK deposit scheme does not reimburse the account holder in case the deposits are lost because of, for example, insolvency of Paragon Group. Loans to Paragon Bank Plc borrowers who have deposits in excess of £85,000 may not be added to the portfolio if the aggregate set-off exposure exceeds 0.5%.

Deposit set-off risk has not been modelled in this transaction because of the low exposure covenant described above which limits the exposure to set-off.

Securitisation structure description

The originators and sellers, Paragon Banking Group 2010 Limited ("PML") and Paragon Bank Plc, will sell portfolios of residential buy-to-let mortgage loans to the issuer, Paragon Mortgages (No.25) PLC.

At closing, the issuer will issue the notes and certificates to finance the purchase of the initial asset pool. During the substitution period lasting five years and as long as the relevant conditions are met, either of the sellers can sell more loans to the issuer. Each seller will service the assets it has sold to the issuer, although PML will take the lead in servicing with respect to any dealings with the issuer.

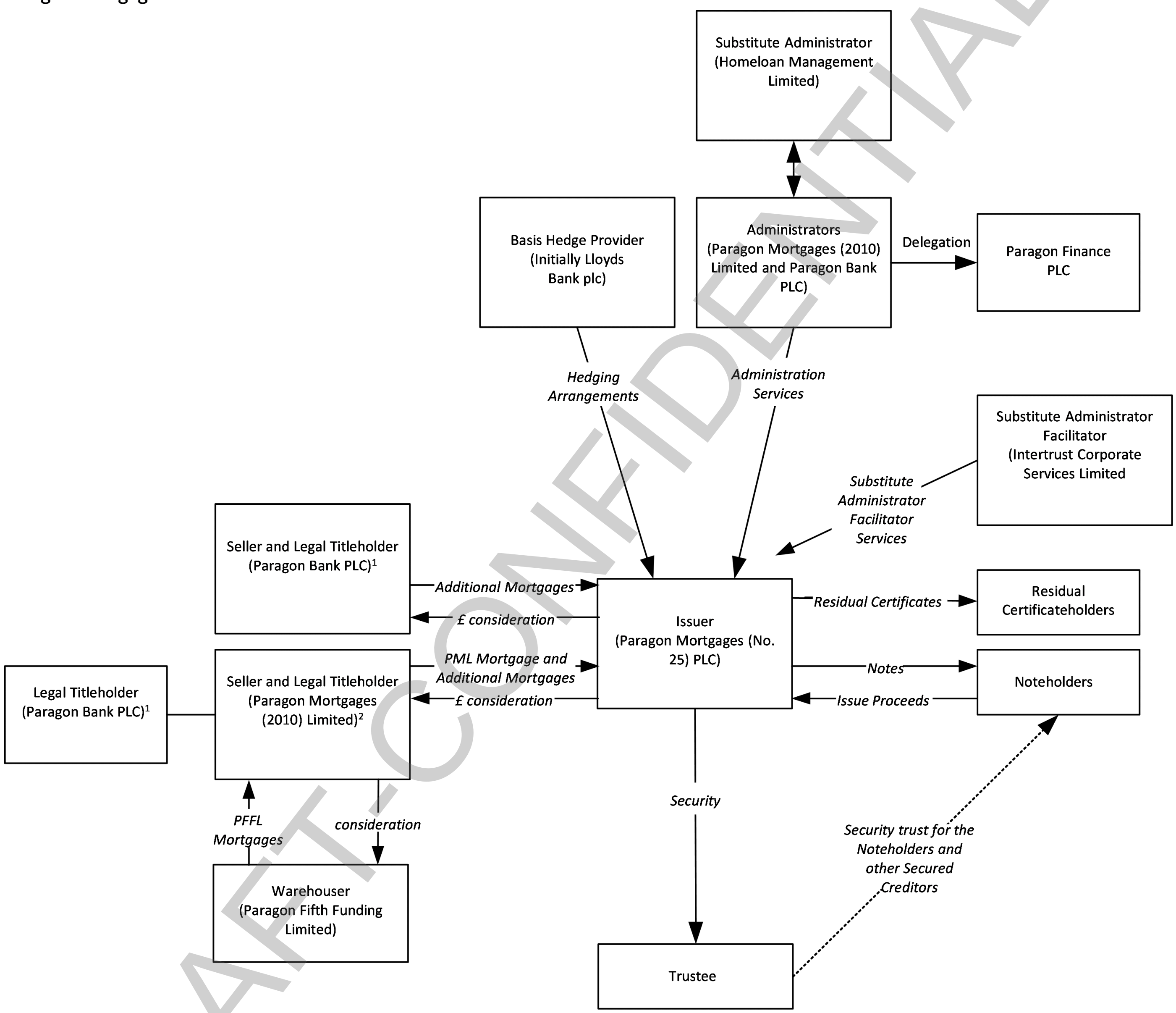
The Class S notes and Class S variable funding notes ("VFN") are issued to finance certain start-up costs of the issuer, as well as to fund the initial reserves and any future discretionary reserves. PML will be granted RC1a and RC2a residual certificates and PB will be granted RC1b and RC2b residual certificates.

This entitles them to receive deferred consideration on the loans sold to the issuer. Exhibit 12 illustrates all the parties and their respective roles.

Structural diagram

Exhibit 12

Paragon Mortgages 25 PLC transaction structure



Source: Moody's Investors Service

Detailed description of the transaction

Credit enhancement

The Class A notes benefit from the subordination provided by more junior notes, namely Class B-Z notes. The S notes and S VFN are used (among other things) to fund the issuers' various reserves, while the RC1 and RC2 notes are used to record the entitlement to excess spread.

At closing, the aggregate reserve funds will be sized to be 1.5% of the initial principal balance of the rated notes. An amount corresponding to 1.5% of the Class A and Class B notes outstanding will form the Class A and Class B note liquidity reserve fund, which will cover interest shortfalls on Class A and Class B notes and senior expenses. A further 1.5% of the Class C and D notes will form the general reserve fund. The reserve funds both amortise, and amounts not needed after amortisation will be added to the issuers available revenue funds, which can cover all items of the revenue waterfall, including the PDL for all notes. The transaction has annualised excess spread at closing of around 1.31 % (after the swap). The other reserve fund is the general reserve fund, which is sized at 1.5% of the Class C and D notes outstanding, which is available to cover senior expenses as well as A, B, C and D note shortfalls.

The reserve funds will not amortise in certain circumstances, including being funded below their target level at the previous interest payment date, or when the cumulative amounts debited to the PDL exceed 1% of Classes A-Z.

Flow of funds

Allocation of payments/pre-accelerated revenue waterfall: On each quarterly payment date, the issuer's available funds (that is, interest amounts received from the portfolio, the reserve funds, funds received under the swap agreement, interest earned on the issuer's account and eligible investments, principal addition amounts and amounts released from the conversion, and margin reserves) will be applied in the following simplified order of priority and only to the extent that the payments of higher priority have been made in full:

1. Senior fees and expenses to various parties
2. Payments to the swap providers (other than subordinated amounts)
3. Interest on the Class A notes
4. Eliminating any debit balance on the PDL that exceeds the aggregate current principal outstanding of the Class B notes, the Class C notes, the Class D notes and the Class Z notes
5. Interest on the Class B notes
6. Amounts required to replenish the Class A and Class B liquidity reserve fund up to its target size
7. Eliminating any debit balance on the PDL that exceeds the aggregate current principal outstanding of the Class C notes, the Class D notes and the Class Z notes
8. Interest on the Class C notes
9. Eliminating any debit balance on the PDL that exceeds the aggregate current principal outstanding of the Class D notes and the Class Z notes
10. Interest on the Class D notes
11. Eliminating any debit balance on the PDL that exceeds the current principal outstanding of the Class Z notes
12. Issuer profit amount (£250 a quarter)
13. Amounts required to replenish the general reserve fund up to its target size
14. Eliminating any remaining debit balance on the PDL
15. On any interest payment date occurring before the step-up date, towards funding the mortgage margin reserve fund and the conversion margin reserve fund in connection with the acquisition of additional loans or interest rate converted mortgages expected during the next collection period
16. Other costs, payments or fees because of third parties
17. Hedge subordinated amounts
18. On any interest payment date occurring on or after the step-up date or the final redemption date, to apply all amounts as available principal receipts
19. Interest due on the Class Z notes

20. Interest due on the Class S notes
21. Principal due on the S notes (subject to the principal payment not reducing the balance of the S note below the required level of the respective reserve fund)
22. First interest and then principal due on the S VFN notes
23. Purchase of additional hedging arrangements
24. Junior fees and expenses
25. On any interest payment date before (but excluding) the step-up date, all excess amounts to be paid to the RC1 certificate holders and thereafter, to the RC2 certificate holders

Interest on Classes B, C, D and Z notes is deferrable as long as they are not, at that point in time, the most senior outstanding class of notes. Interest is not deferrable on Class A or the most senior class of notes.

Allocation of payments/pre-accelerated principal waterfall*:* On each quarterly payment date, the available principal receipts, which include principal amounts received from the portfolio, amounts applied to clear the PDL and amounts in the retained principal ledger, but which are reduced by principal addition amounts (principal receipts to pay Class A and in certain circumstances Class B interest), will be applied in the following order or priority and only to the extent that the payments of higher priority have been made in full:

1. Towards mandatory further advances to the extent that the issuer has insufficient reserves to cover such amounts
2. Towards discretionary further advances
3. Refunding incorrect direct debit payments taken (if any)
4. During the revolving period, amortising the Class A notes until the target class A notional has been reached
5. During the revolving period, to purchase new loans
6. During the revolving period, to deposit any unused funds to the retained principal ledger subject to the maximum retained principal amount
7. Any amounts exceeding the maximum retained principal amount or after the revolving period end date to amortise the notes sequentially in order of seniority as follows: Class A notes, Class B notes, Class C notes, Class D notes, Class Z notes, Class S notes and Class S VFN
8. After the end of the revolving period, to amortise the notes sequentially in order of seniority: principal due on the Class A notes
9. All remaining amounts to be applied as available revenue receipts

The maximum retained principal amount is an amount equal to 5% of the aggregate of the current balance of all loans in the portfolio from time to time.

Allocation of payments/PDL-like mechanism

A PDL is recorded for realised losses on the portfolio and when there has been application of principal receipts to meet any items in the interest waterfall.

Realised losses are defined as any losses arising in relation to a loan in the portfolio, which causes a shortfall in the amount available to pay principal on the notes, but may be reduced if subsequent recoveries, are received by the issuer on those loans. Losses arising because of borrowers applying set-off have not been included in the definition of realised loss.

Reserve fund

At closing, the Class A and B liquidity reserve fund will be funded with the proceeds of the Class S notes for an amount corresponding to 1.5% of the aggregate Class A and B notes issuance size. The general reserve fund is funded via the same means at 1.5% of the sum of the Class C and D notes issuance sizes.

The reserve funds amortise to maintain 1.5% of the respective principal outstanding of the relevant notes. The reserve funds stop amortising if the balance of mortgages more than three months in arrears exceed 3% of the securitised mortgage pool or if the cumulative amount debited to the PDL since closing exceeds 1% of the initial notes balance (A to Z).

Liquidity

Liquidity is provided as follows: in the event of a shortfall in available revenue funds to pay senior expenses, Class A and Class B interest, the Class A and B liquidity reserve fund is used.

If the issuer still has a shortfall in revenue receipts to pay rated note interest or senior expenses, or both, then the general reserve fund may be used.

Finally, principal is available to pay senior expenses, Class A and Class B note interest once the above two reserves have been exhausted (subject to no more than 50% Class B PDL when it comes to Class B interest being paid). Such diversions of principal result in a debit to the PDL.

Asset transfer

The residential mortgage loans in the pool have been transferred to the issuer through an equitable assignment. Notification of redirection of payments to the issuer's account occurs upon perfection of legal title, which would take place, for example, in case of insolvency of the seller/servicer or an enforcement notice being served on the issuer.

Cash manager

The cash manager in the transaction is PML. Its main responsibilities are the determination of cash flow amounts, and maintenance of ledgers and preparation of investor report. The main responsibilities of the backup servicer facilitator, Intertrust Management Limited, are to use its best efforts to appoint a backup servicer in case PML or PB cannot perform their servicing duties any longer.

Enforcement of representations and warranties (R&W)

Loan repurchase following breach of R&W: if material breaches of R&W have not been remedied within 28 days of being notified by the issuer of such breaches, the relevant seller shall repurchase the loan from the issuer.

Securitisation structure analysis

Our ratings are based on the quality of the asset pool, the levels of credit enhancement, the liquidity provided by the reserve fund, and the structural and legal integrity of the transaction. The ratings on the notes address the likelihood of receipt by noteholders of timely payment of interest and ultimate payment of principal at par on or before the rated final legal maturity date for all rated notes. Our ratings address only the credit risks associated with the transaction.

Primary structural analysis

We consider the probability of default under the notes, as well as the estimated severity of loss, when assigning a rating.

Tranching of the notes

Once the loss distribution of the pool under consideration has been computed, a cash flow model is used to assess the impact of the structural features of the transaction. It calculates the average lives and the losses experienced by the notes for every loss scenario for the portfolio. Based on these numbers, the expected loss and the WA lives of the notes are calculated as WAs based on the probabilities of the respective scenarios. The expected loss on each tranche, together with the notes' WA life, determines the rating, which is consistent with our target losses for each rating category.

Spread compression

In our cash flow modelling, we took into account the decline in the average spread on the pool over time, described in "Detailed description of the transaction" – The level of excess spread could decline, above.

The transaction benefits from a series of fixed-floating swaps provided by Lloyds Bank Plc (Aa3/P-1/Aa3(cr)/P-1(cr)), whose notional covers the fixed portion of the pool until the fixed-rate loans switch to their reversionary floating rate or SVR. Under the swap agreement, the issuer will pay a blended swap rate and will receive 3-month GBP Libor as is owed to the notes. As the portfolio can substitute, further swaps will be entered into as new tranches of loans are sold to the issuer, to hedge the fixed-rate loans entering the pool. As the new hedges are entered into, the swap rate can vary. Furthermore, the issuer has the leeway to permit that the hedged notional of fixed rate loans is 310 million above or below the actual principal outstanding balance of the fixed rate loans in the loan portfolio from time to time.

The collateral trigger for the fixed-rate swap has been set at loss of A3(cr) and the replacement trigger at loss of Baa1(cr). The transfer trigger level is lower than that of a typical UK standalone RMBS transaction; however, given the current rating of the swap counterparty, the level of the trigger does not have a negative impact on the ratings of the notes.

The swap documents are substantially consistent with Moody's methodology to assess counterparty exposure (see Moody's Approach to Assessing Counterparty Risks in Structured Finance, published in July 2017).

Subordinated swap amounts: Should the swap be terminated with the swap counterparty as either the sole affected party or the defaulting party, the swap termination payment is subordinated in the waterfall. However, the payment ranks ahead of clearing the Class Z PDL. Therefore, should such a swap termination payment be due at the same time that there are losses in the loan portfolio, excess spread would go to the swap counterparty first as opposed to benefiting the noteholders by provisioning for such losses through the PDL.

Assumptions and definitions

We use the following main assumptions and definitions in our cash flow modelling:

» Assumptions:

- Stressed fees are 0.30% per annum subject to a floor of £50,000.
- The WA asset interest rate at closing is 3.00% over 3-month GBP Libor. The WA asset coupon after reset is 3.0% over note 3-month GBP Libor. The fixed-rate portion of the pool resets to floating rate after five years.
- The constant prepayment rate modelled is 15.0% or 30.0% .
- There is no interest modelled on cash in the issuer's accounts.
- The step-up date is in 15 May 2023.

» Definitions:

- The PDL records any losses on the assets and the application of any principal to meet any income deficit.
- Default definition is not applicable given that the PDL records losses.

Comparables

Exhibit 13 shows the main structural features of the current transaction compared with those of the peers that our Rating Committee made the main benchmarking against.

Exhibit 13
Benchmark table for structural features

Deal Name	Paragon Mortgages No.25	Paragon Mortgages (No. 24) PLC	Paragon Mortgages (No. 23) PLC	Precise Mortgage 2018-2B PLC	Precise Mortgage 2018-1B PLC2	Precise Mortgage 2017-1 PLC	London Wall Mortgage Capital Series Fleet 2017-1	Malt Hill No. 1 plc2	Offa No. 1 plc
Notes Payment Frequency	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly
Replenishment periods	5 years	0	0	None	None	None	None	None	None
Total Aaa size	85.00%	84.73%	87.30%	90.50%	90.50%	84.00%	85.00%	87.00%	92.50%
RF at Closing§	1.50%	2.50%	2.50%	1.50%	1.50%	2.00%	2.00%	1.60%	2.50%
RF Fully Funded at Closing?§	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
RF Floor§	No floor	N/A	N/A	1.50%	1.50%	2.00%	Non-amortising	Non amortising	Non amortising
Hedge in place	Fixed-floating swap	Fixed-floating and cross-currency swaps	Fixed-floating and cross-currency swaps	Fixed-Floating	Fixed-Floating	Fixed-Floating	Fixed-Floating swap	Yes	Yes
Swap rate or guaranteed XS (if applicable)	N/A	N/A	N/A	N/A	N/A	N/A	Fixed rate	N/A	2.50%
Principal to pay interest?	Yes, Limited	Yes	Yes	Yes	Yes	Yes for A and B	Yes	Yes	Yes

§ The reserve fund is as percentage of rated note balance.
Source: Moody's Investors Service

Additional structural analysis

Cash commingling

All the payments under the loans in this pool are paid into a collection account in the name of each seller, either at NatWest Bank (A2/P-1/Aa3(cr)/P-1(cr)) or Barclays Bank PLC (A2/P-1/A2(cr)/P-1(cr)). The following mitigants to commingling risk and collection account bank default risk are included in the structure:

» *Daily transfer of payments to the issuer account held by* Citibank, N.A., London Branch (A1/(P)P-1/A1(cr)/P-1(cr))

» *Collection account declaration of trust:* The seller has declared a trust (among the issuer, the seller and the collection account banks) over the collection accounts in favour of the issuer

» *Transfer trigger for the collection account:* Should either of the collection accounts be downgraded below Baa3, they need to be replaced

Given the aforementioned mitigants, commingling risk has not been modelled.

Mitigating servicing disruptions

Homeloan Management Limited (not rated) (has been appointed as backup servicer and cash manager, via the backup administration agreement. It has agreed to a relatively tight window of five days in which it will step in to assume either or both of the duties in case the sellers are unable to perform such duties.

Furthermore, Intertrust Management Limited (not rated) has been appointed as backup administrator facilitator, a positive feature. In case HML and the sellers/administrators are unable to perform their duties, it will use best efforts to appoint a replacement administrator.

In the event the servicer report is not delivered in time, the administrator shall base the payments on estimates using the last three verified servicing reports, and once it receives the servicer report, it will reconcile the estimates with the actual figures and if needed make additional payments.

Also, the swap payment can be based on estimates in absence of the servicer report. It should be noted that revenue receipts can leak out of the transaction during a servicer interruption. However, any reconciling amounts because of a swap counterparty following estimation as a result of operational risk will only be paid to the extent cash is available and such a shortfall will not cause a termination of the swap.

Liquidity of around 8 months of interest payments and senior expenses on the rated notes is provided by the two reserve funds assuming current 3-month GBP Libor and current hedging in place, including the swap costs. This would drop to 2.6 months in case of loss of the swap and assumed 3-month GBP Libor of 5.7%.

Methodology and monitoring

Overview

The principal methodology used in this rating was Moody's Approach to Rating RMBS Using the MILAN Framework , published in September 2017.

We will monitor the transaction on an ongoing basis to ensure that it continues to perform in the manner expected, including checking all supporting ratings and reviewing periodic servicing reports. Any subsequent changes in the rating will be publicly announced and disseminated through Moody's client service desk.

Significant influences : In addition to the counterparty issues noted, further deterioration in the housing market beyond that modelled may have an impact on the subject transaction's ratings.

Factors that could lead to an upgrade

» Better performance of the underlying collateral than initially expected

» Deleveraging of the capital structure

Factors that could lead to a downgrade

» Material reduction in creditworthiness of the seller/servicer or of the other transaction counterparties

» Significant deterioration in the UK economy and real estate market

» Unforeseen legal or regulatory changes

Monitoring triggers

Interest rate swap triggers [1]

» Remedy for loss of A3(cr) is to post collateral.

» Remedy for loss of Baa1(cr) is to replace the swap counterparty or obtain a guarantee from a guarantor.

For issuer account bank triggers [2]

» Loss of A3 (senior unsecured rating), remedy is to replace or find a guarantor

» Eligible investments must be rated at least A2 and P-1

For collection account bank

» Loss of Baa3 (senior unsecured rating), remedy is to replace or find a guarantor

Monitoring report

Data quality

» The investor report format is being finalised.

» The report is likely to be in line with previous Paragon deals and so in line with other transactions in the sector.

» There is an undertaking to provide us with an updated pool cut once a quarter.

» Loan modifications for arrears management are not reported separately.

» Further advances are reported in the investor reports.

Data availability

» The report is provided by Paragon Banking Group (2010) Limited

» The timeline for the investor report is provided in the transaction documentation; the priority of payment section is published on the interest payment date.

» The investor report is likely to be completed no later than 30 days following the end of the relevant collection period.

» The frequency of the publication of the investor report is quarterly and the frequency of the interest payment date is quarterly.

» Investor reports are publicly available on a website.

The analysis that we undertook at the initial assignment of a rating for an RMBS security may focus on aspects that become less relevant or typically remain unchanged during the surveillance stage. Please see Moody's Approach to Rating RMBS Using the MILAN Framework for further information on our analysis at the time of the initial rating assignment and the ongoing surveillance in RMBS.

Parameter sensitivities

Parameter sensitivities provide a quantitative, model-indicated calculation of the number of notches by which a structured finance security rated by us may vary if certain input parameters used in the initial rating process differed. The analysis assumes that the deal has not aged. It is not intended to measure how the rating of the security might migrate over time, but rather, how the initial rating of the security might differ as certain key parameters vary.

Parameter sensitivities for this transaction were calculated in the following manner: Moody's assumed 16 loss distributions derived from the combinations of MILAN CE: 14.5 % (base case), 17.4 % (base x 1.2), 20.3 % (base x 1.4) and 23.2 % (base x 1.6) and expected loss: 1.25 % (base case), 1.88 % (base x 1.5), 2.50 % (base x 2) and 3.75 % (base x 3). The 1.25 %/ 14.5 % scenario would represent the base case assumptions used in the initial rating process.

Exhibits 14-17 show the parameter sensitivities for this transaction with respect to the tranche rated by us.

Exhibit 14

Class A

		MILAN CE			
		14.5%	17.4%	20.3%	23.2%
Expected Loss	1.25%	Aaa(0)	Aaa(0)	Aaa(0)	Aaa(0)
	1.88%	Aaa(0)	Aaa(0)	Aaa(0)	Aa1(-1)
	2.50%	Aaa(0)	Aaa(0)	Aa1(-1)	Aa1(-1)
	3.75%	Aaa(0)	Aa1(-1)	Aa1(-1)	Aa2(-2)

Source: Moody's Investors Service

Exhibit 15

Class B

		MILAN CE			
		14.5%	17.4%	20.3%	23.2%
Expected Loss	1.25%	Aa1(0)	Aa1(0)	Aa1(0)	Aa2(-1)
	1.88%	Aa1(0)	Aa2(-1)	Aa2(-1)	Aa3(-2)
	2.50%	Aa2(-1)	Aa2(-1)	Aa3(-2)	A1(-3)
	3.75%	Aa2(-1)	Aa3(-2)	A1(-3)	A2(-4)

Source: Moody's Investors Service

Exhibit 16

Class C

		MILAN CE			
		14.5%	17.4%	20.3%	23.2%
Expected Loss	1.25%	A1(0)	A2(-1)	Baa1(-3)	Baa3(-5)
	1.88%	A1(0)	A3(-2)	Baa2(-4)	Ba1(-6)
	2.50%	A2(-1)	Baa1(-3)	Baa2(-4)	Ba2(-7)
	3.75%	A2(-1)	Baa1(-3)	Baa3(-5)	Ba2(-7)

Source: Moody's Investors Service

Exhibit 17

Class D

		MILAN CE			
		14.5%	17.4%	20.3%	23.2%
Expected Loss	1.25%	Baa1(0)	Baa3(-2)	Ba2(-4)	B3(-8)
	1.88%	Baa2(-1)	Ba1(-3)	Ba3(-5)	Caa1(-9)
	2.50%	Baa2(-1)	Ba1(-3)	Ba3(-5)	Caa1(-9)
	3.75%	Baa3(-2)	Ba1(-3)	Ba3(-5)	Caa1(-9)

Results under base case assumptions indicated in the top left corner. Change in model output (# of notches) is noted in parentheses.
Source: Moody's Investors Service

Moody's related research

For a more detailed explanation of Moody's approach to this type of transaction, as well as similar transactions, please refer to the following reports:

Methodologies used:

» Moody's Approach to Rating RMBS Using the MILAN Framework, September 2017

» Approach to Assessing Counterparty Risks in Structured Finance, July 2017

New issue and pre-sale reports

» Precise Mortgage Funding 2018-1B Plc - New Issue Report, January 2018 (SF1109505)

» Precise Mortgage Funding 2017-1B Plc - New Issue Report, April 2017 (SF1068934)

» Offa No. 1 Plc – New Issue Report, March 2016 (SF429033)

» Malt Hill No. 1 Plc – New Issue Report, June 2016 (SF433298)

» Paragon Mortgages No. 24 Plc – New Issue Report, November 2015 (SF421266)

Special reports

» Falling Rents in London and South East England Are Credit Negative for UK Buy-to-Let RMBS, March 2017 (SF449330)

» RMBS - United Kingdom: Credit Impact of Brexit on UK RMBS Likely to be Minor, But London's Property Market Could be More Affected, May 2016 (1025806)

» RMBS and ABS - United Kingdom: Brexit More Negative for UK NonConforming RMBS than for Prime RMBS and ABS in Downside Macro Scenario, September 2016 (1038141)

» UK Vote for EU Exit Signals A Prolonged Period of Uncertainty, A Credit Negative: Moody's Cross Sector Credit Views, June 2016 (1031342)

» Lenders with Limited Track Record in EMEA RMBS: Challenges and Mitigants, June 2016 (1016956)

Special comments:

» Buy-to-let RMBS - UK: Performance Update - Excel, February 2018 (1113645)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Appendix 1: Summary of the originator's underwriting policies and procedures

Originator Ability	At closing
Sales and Marketing Practices	
Origination channels:	95% brokers, 5% direct customer enquiries
Role of the intermediaries/brokers:	The intermediary acts as the applicants adviser and submits application information only. Validation is carried out by Paragon.
Frequency of intermediaries/brokers monitoring:	Brokers are subject to initial due diligence and monitoring of performance is ongoing.
Compensation/ incentive structure of sales team (brokers/intermediaries and branches):	Intermediaries are paid a procuration fee for introducing an application typically between 0.5% and 0.75% of the loan on completion. Paragon regional managers are compensated with a mix of basic salary and bonus. The bonus will typically equate to 20 - 25% of basic salary.
Separation and independence of sales and approval function:	Sales and underwriting operate independently and report through separate directors. Sales have no underwriting mandate.
Underwriting Policies and Procedures	
% of loans automatically underwritten (i.e. without manual approval):	0% - All loans are written based upon manual approval. The system based underwriting system is designed to filter applications and assist the underwriter, not replace them.
% of loans manually underwritten:	100%
Back-testing of automatic underwriting/internal score (if applicable):	Both manual and credit score assisted processes are reviewed on an ongoing basis and credit reports produced monthly to the Group Credit Committee.
Average experience in underwriting or tenure with company:	44% 0-5 years , 12% 5-10 and 44% with 10+ years' experience
Ratio of loans underwritten per FTE1 per day:	Within a range 2 - 4 (depending on complexity)/day
Criteria for compensation of underwriters:	Underwriters are compensated on basic salary only (no performance related bonus) and also participate in a Group wider profit related pay scheme which pays an annual sum based on a distribution of 1% of the Group's gross profit. The average over the last 5 years per employee was £1.4k
Approval rate:	The approval rate is circa 55%

Originator Ability	At closing
Sales and Marketing Practices	
Mandate/lending authority for first level underwriter/personnel:	£100k 75%LTV - is the lowest level mandate authority.
Percentage of exceptions to underwriting policies:	There are deminimis (<0.2%) exceptions to underwriting policy
Process and tools for the borrower identity check:	The solicitor acting for Paragon is required to complete identity checks in line with UK anti-money laundering regulation. In addition - data supplied by the credit reference agencies is used to check for M/L compliance.
Fraud prevention tools and % of applicants checked for fraud:	100% All cases are checked against Sira & Cifas databases.
Source of credit history checks:	Equifax and Credit safe are used as suppliers of consumer and commercial credit data within the underwriting process. All personal applicants and all corporate applicants are searched using these systems.
Credit history requirements:	No material adverse credit
Use of external credit bureau scores:	Personal Applicant -Equifax - Risk Navigator score - 320. Corporate applicants - Credit Safe - 30
Use of internal credit scores:	None
Methods used to assess borrowers' repayment capabilities:	All mortgages are BTL. A minimum interest coverage ratio is used to assess affordability. For non portfolio borrowers the ICR is determined by the tax band applicable to the applicants income. For basic tax payer = 125%, higher rate tax payer = 140%. For portfolio borrowers the ICR is determined using a combination of the tax band and the property type. Single self contained properties range from 125% - 140% and HMO's multi-unit blocks from 130% - 145%

Source: Paragon Banking Group

Originator Ability	At closing
Income taken into account in affordability calculations:	There is a minimum of £25k requirement in all cases
Other borrower's exposures (i.e. other debts) taken into account in affordability calculations:	Information on other debts and liabilities is collected and recorded and may be taken into account but the affordability assessment is driven by the property information.
Is interest rate stressed to calculate affordability?	The interest rate is stressed as follows: Current Affordability (ICR reference rate) – Non 5 year fixed product uses charging + 2% or 5.5%, whichever is greater – 5 year fixed currently uses 4% or product charging rate, whichever is greater Future Affordability – Non-5 year fixed products uses reversion rate + predicated change in bank base rate – 5 year fixed products uses reversion rate + 0.5% (outside of regulation)
Is amortisation modified to calculate affordability for I/O/balloon loans?	No
Method used for income verification	Rental income is assessed by the Group's surveyors or by a group appointed panel valuer, the valuation which is validated by a Paragon group surveyor
Criteria for non-income verified and %:	Not applicable
Maximum age at maturity &assessment of income for pensioners:	Not applicable
Maximum loan size:	£10m (in aggregate)
Valuation types used for purchase & LTV limits:	Full physical inspection 80%
Valuation types used for remortgage & LTV limits:	Full physical inspection 80%
Valuation types used for further advances & LTV limits:	Full physical inspection 80%
Valuation types & procedure for construction loans & LTV limits:	Not applicable
Valuation types & procedure for new built properties & LTV limits:	Full physical inspection 80%

Originator Ability	At closing
LTV limit for first-time-buyers/Buy-to-let/other (please specify and delete non relevant criteria):	Maximum LTV:80% up to £500k, 70% up to £1 million and 65% up to £2 million
Collateral Valuation Policies and Procedures	
Value in the LTV calculation for underwriting purpose:	Lower of the purchase price or valuation
Value in the LTV recorded in database system if different than above	Lower of the purchase price and valuation (separately the purchase price)
Type, qualification and appointment of valuers:	Internal Surveyors Team (all RICS qualified 10 yrs post qualified experience). Where necessary we will instruct a panel surveyor (all RICS qualified) but these will be subject to a 100% audit by the internal surveyors function.
Monitoring of quality of valuers:	All valuations subject to a regular random audit conducted by senior audit
Closing Policies and Procedures	
Quality check before releasing funds:	Letter/phone calls to confirm borrower information, validation that insurance is in place, check with notary, etc.
Entity responsible for the deed registration & time needed:	The solicitor acting for Paragon will register the charge in accordance with Paragon's instructions to solicitors
Data quality check (check that system and paper file match):	100%, via Image system
Credit Risk Management	
Credit risk team employees and experience:	Credit risk team operates with two senior, experienced staff and 4 analysts. Head of Department has 12 years with Paragon(23 years in credit risk industry). Senior
Reporting line of Chief Risk Officer :	Chief Executive Officer
Ability to track loan performance by specific loan characteristics?:	Yes, performance can be tracked by any characteristic recorded on Paragon system. E.g. originator, valuer, solicitor, loan size, score etc.

* FTE: Full Time Equivalent
Source: Paragon Banking Group

Originator Stability:	At closing
Quality Controls and Audits	
Responsibility of quality assurance:	Independent team (part of team of six) under the control of a team leader (separate to the underwriting area)
Number of files per month being monitored:	100% audit post offer and post completion with findings passed back to underwriting team leader on a monthly basis.
Recording of quality assurance findings and analysis of causes:	Yes and Yes
Frequency of operational audits for the underwriting processes:	Annually
Management Strength and Staff Quality	
Average turnover of underwriters:	Average turnover of underwriters for the last 2 years 1st Apr 16 to 31st Mar 17: 2 leavers and 9 new starters 1st Apr 17 to 31st Mar 18: 1 leaver and 12 new starters
Training of new hires and existing staff:	Buddy principle - mixing training with 4 eye review (finally hierarchical mandate approval process). Then ongoing review for quality.
Technology	
Main software used:	ARIES is the core component of the Paragon First Mortgage systems that support all phases of flexible, repayment, endowment, rest or interest only mortgage operations, from initial application processing through servicing, accounting and collections. There are interfaces to the general ledger accounting System 21 and to various administrative systems used by finance and treasury operations. The software schedule is operated through ROBOT. A monthly process known as the collection run calculates the monthly interest owed by the customer, generates insurance premiums and creates an extract file of customer payments to be submitted to BACS. Overnight, weekly and monthly process produces reports and statistical information on redemptions, mortgage arrears and insurance premiums.
Tools/infrastructure available:	See below.
Back-up server synchronisation and distance from main server:	Paragon uses two IBM I Power 7 (previously known as iSeries and earlier as AS/400) computers to operate all its product application, account administration and general ledger systems. POWER7 (P7) processor technology is designed to deliver performance, scalability, reliability, and manageability that is required for the high I/O and memory applications used by the Group. The Power 720 server is a high-performance, energy efficient, reliable, and secure infrastructure and application server with innovative workload-optimizing and energy management technologies.
Frequency of disaster recovery plan test:	Tests are carried out on a monthly basis with a full test of the BCP taking place annually. A full exercise schedule is signed off annually by the BC Working Group.
Securitisation related	
%age of book securitised	As at September 2015, the securitised assets, as a percentage of the buy to let assets, was approximately 47.41%.
Previous experience with buy backs from securitisations	There have been no recent repurchases. Historically, there has been one repurchase where the solicitor failed to register Paragon's charge.

Source: Paragon Banking Group

Appendix 2: Summary of the servicer's collection procedures

Servicer Ability	At closing
Loan Administration	
Entities involved in loan administration:	None
Abandonment rate (% call not answered within 20 seconds):	Less than 1% Collections
Early Arrears Management	
Entities involved in early stage arrears:	Internal Collections team
Hours & days of operation:	Mon to Fri 8am to 8pm. Sat 8am to 5pm
Ratio of loans per collector (FTE)1:	Around
Definition of arrears & default	UK Standard - 3 periods
Pre-arrears strategy: Do you contact the borrower to remind that the payment prior to account is due?	Yes
Pre-arrears strategy: If yes, how do you select the account to be called,	Behavioural analysis and proactive arrangement contact
Arrears strategy for 1-29 days delinquent (please select and if needed customise the relevant option)	From day 1 - letter sent & collection calls, supported with Field Calls and daily attempts at contact
Arrears strategy for 30 to 59 days delinquent (please select and if needed customise the relevant option)	From day 30 - as above
Arrears strategy for 60 to 89 days delinquent (please select and if needed customise the relevant option)	At Day 60 - normally final pre-Receiver-of-Rent Field Call and then instruction of Receiver-of-Rent From day 60-90 Receiver-of-Rent normally appointed Simultaneous collections contact continues
Arrears strategy for 90 days or more delinquent to late stage (please select and if needed customise the relevant option)	Receiver-of-Rent normally appointed
Prioritisation rules for delinquent accounts:	Level of arrears, type of portfolio, payment type missed
Use of historical payment behaviour in the collection strategy:	Aged history used showing arrears now, previous month and previous year
Data enhancement if borrower is not contactable:	Field calls, directory enquiries, bank letters and trace companies
Reason for non-payment:	Arrears reason code data collected
Loss Mitigation and Asset Management Practices:	
Transfer of a loan to the late stage arrears team:	Normally Receiver-of-Rent from Day 60 and Pre-Salvage where forecast loss subsequently identified at Day 60
Entities involved in late stage arrears:	Collections, Portfolio Relationship, Receiver, Field Team
Entities involved in loss mitigation	Portfolio Relationship, Pre-Salvage, Receiver, Litigation, Negligence review, external solicitors, Telephone Collections
Hours & days of operation:	Telephone Collections as per Early Arrears Management. Other units normally Mon to Fri, 8.30am to 5.00pm
Ratio of loans per collector (FTE):	Included in previous figure for collections
Analysis performed to assess/propose loss mitigation solutions:	Review including LTV, interest due vs. interest paid, pre-salvage review, information from PRM visits and negligence review
Types of loss mitigation solutions including percentage defined as the number of accounts which were 30+ delinquent for which one solution has been applied divided by the total number of accounts which were 30+ delinquent over the past 12 months.	N/a

Servicer Ability	At closing
Role of field agents:	Supporting Receiver-of-Rent in tenant contact and property management
Borrowers re-defaulting 90 days or more after loss mitigation:	N/a
Contact with borrower during the legal process:	N/a
Time from first default to litigation and from litigation to sale:	N/a
Average recovery rate on closed files, recovery time and change in price of properties sold:	N/a

Source: Paragon Banking Group

Servicer Stability	
IT and Reporting	
Main software used and its operating manual:	ARIES is the core component of the Paragon First Mortgage systems that support all phases of flexible, repayment, endowment, rest or interest only mortgage operations, from initial application processing through servicing, accounting and collections. There are interfaces to the general ledger accounting System 21 and to various administrative systems used by finance and treasury operations. The software schedule is operated through ROBOT. A monthly process known as the collection run calculates the monthly interest owed by the customer, generates insurance premiums and creates an extract file of customer payments to be submitted to BACS. Overnight, weekly and monthly process produces reports and statistical information on redemptions, mortgage arrears and insurance premiums.
Tools/infrastructure available:	Please see above
Automatic tracking and reporting of specific characteristics:	Generic Event management System (GEMS)
Back-up server synchronisation and distance from main server:	Paragon uses two IBM I Power 7 (previously known as iSeries and earlier as AS/400) computers to operate all its product application, account administration and general ledger systems. POWER 7 (P7) processor technology is designed to deliver performance, scalability, reliability, and manageability that is required for the high I/O and memory applications used by the Group. The Power 720 server is a high-performance, energy efficient, reliable, and secure infrastructure and application server with innovative workload-optimizing and energy management technologies.
Frequency of disaster recovery plan test:	Tests are carried out on a monthly basis with a full test of the BCP taking place annually. A full exercise schedule is signed off annually by the BC Working Group.
Main software used and its operating manual:	ARIES is the core component of the Paragon First Mortgage systems that support all phases of flexible, repayment, endowment, rest or interest only mortgage operations, from initial application processing through servicing, accounting and collections. There are interfaces to the general ledger accounting System 21 and to various administrative systems used by finance and treasury operations. The software schedule is operated through ROBOT. A monthly process known as the collection run calculates the monthly interest owed by the customer, generates insurance premiums and creates an extract file of customer payments to be submitted to BACS. Overnight, weekly and monthly process produces reports and statistical information on redemptions, mortgage arrears and insurance premiums.
Tools/infrastructure available:	Please see above
Automatic tracking and reporting of specific characteristics:	Generic Event management System (GEMS)
Securitisation related	
Securitised loans in the servicers portfolio	As of 30 September 2017, there are £7,781.8 million of securitisation and warehouse funding outstanding which constitutes 53% of the total loan book.
Are defaulted loans in the securitisations checked for breach of representations and warranties?	Some cases are referred to the Securitisation Compliance area

Source: Paragon Banking Group

Appendix 3: Originator and servicer reviews

Exhibit 18
Summary of originator and servicer assessment

Originator Assessment	Main Strengths (+) and Challenges(-)
Overall Assessment:	Average
Originator Ability	
Sales & Marketing Practices	+ Separate sales and underwriting function
	+ One-to-one meetings with professional landlords
	- Origination channels: 90% brokers vs. 10% packagers
Underwriting Policies & Procedures	+ Depending on the complexity of the file underwriters undewrite 2 - 4 applications per day
	+ No exceptions allowed.
	+ No CCJ and no self-certification
	- Income data is collected yet is not relied upon in the affordability calculation
Property Valuation Policies & Procedures	+/- Full internal valuation performed by internal qualified surveyors with 10 years of qualified experience. Expertise on rentability of property is needed.
Closing Policies & Procedures	+ All checks are performed through notary with all documents being imaged
Credit Risk Management	- Specific product though moving more to more risky non-professional landlords
	+ Independent risk management team with separate reporting lines.
	+ Average credit risk experience of management is 20 years
	+/- No changes to underwriting criteria since previous issuance
Originator Stability	
Quality Control & Audit	+ Independent team with 6 people in their team. Small centralised team that can do the checks on underwriters locally.
Management Strength & Staff Quality	+ Average experience of underwriter's manager is 17 years
	+ Large part of underwriting have more than ten years' experience
	+ Training involves "buddy" principle with four eyes review
Technology	+/- Internally built system
	+ Timely information received upon request
	+ Documents are scanned and are available in the head office.
Servicer Assessment:	
Overall Assessment:	Average
Servicer Ability	
Loan Administration	+ All loan administration functions performed centrally
	+ 100% of collections through direct debit
Early Arrears Management	+ Early warning signs used such as cancelled direct debits and through monthly external credit checks for all loans.
	+ Proactive and early contacting of the borrowers.
Loss Mitigation and Asset Management	+ Few repossessions and low losses
	+ Ability to implement portfolio based recovery measures
	- Active receiver of rent strategy to mitigate losses
Servicer Stability	
Management Strength & Staff Quality	+ Very experienced staff
	+ Low turnover
IT & Reporting	+ Frequent back up testing.
Quality control & Audit	+ Overall robust quality control framework
	+ Daily audits to examine the adequacy between issues encountered by borrowers and action taken by collectors
Strength of Back-up Servicer Arrangement:	+ Warm

Source: Moody's Investors Service, based on information provided by Paragon

Endnotes

1 See Approach to Assessing Counterparty Risks in Structured Finance, July 2017.

2 See Approach to Assessing Counterparty Risks in Structured Finance, July 2017.

REPORT NUMBER 1121715

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