

Paragon Mortgages (No.26) PLC

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Capital Structure

Class	Expected Rating	Outlook	Amount (GBP)	Size (%)	CE ^a (%)	Interest Rate (%)	Final Maturity
A1 ^b	AAA(EXP)sf	Stable	TBD	62.00	15.0	SONIA + TBD	May 2045
A2 ^b	AAA(EXP)sf	Stable	TBD	24.50	15.0	SONIA + TBD	May 2045
B ^b	AA (EXP)sf	Stable	TBD	4.00	11.0	SONIA + TBD	May 2045
C ^b	A(EXP)sf	Stable	TBD	3.00	8.0	SONIA + TBD	May 2045
D ^b	BBB(EXP)sf	Stable	TBD	3.25	4.7	SONIA + TBD	May 2045
Z ^b	NR(EXP)sf	n.a.	TBD	3.25	1.5	SONIA + TBD	May 2045
S	NR(EXP)sf	n.a.	TBD	TBD	0.0	SONIA + TBD	May 2045
S VFN	NR(EXP)sf	n.a.	TBD	TBD	0.0	SONIA + TBD	May 2045
Total Issuance			TBD				

^a Credit enhancement (CE): Based on a total asset pool of GBP645.4. million and the credit part of the amortising general reserve of 1.5% of the note classes C and D and the amortising liquidity facility for the note classes A and B.

^b Notes backed by the mortgage pool.

Transaction Summary

Paragon Mortgages (No.26) PLC (PM26) is the 26th 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 were originated between 2010 and 2018, with 95% originated between 2014 and 2018. Unlike the previous transaction in the Paragon Mortgages series, this transaction will not feature a revolving period.

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 Ratings views Paragon's underwriting standards to be in line with its expectations for a prime BTL lender.

Product Switches: While the switches in the repayment types are limited, before the step-up date there are only minor limitations on the potential switches regarding any interest rate conversions. Fitch has therefore modelled extensive use of the interest rate conversions to stress any excess spread in the asset portfolio and hedging interest rate mismatches as outlined below.

Seasoned Portfolio, Typical BTL Characteristics: The mortgages in the portfolio have a high weighted average seasoning at 32 months. In the absence of prepayments, the portfolio is expected to amortise slowly given the high share of interest only loans. As is typical for UK BTL portfolios, more than half of the borrowers are self-employed. Both LTVs and affordability ratios are in line with recent UK transactions.

Interest Rate Mismatch Hedged: At close, 85.5% of the pool will pay a fixed rate of interest (reverting to the SVR or Libor), while the notes pay a SONIA-linked floating rate. A swap hedges the fixed/floating interest rate mismatch. The swap notional assumes no prepayments and might be larger than the fixed-rate mortgage notional. The remainder of the portfolio comprises loans that pay an interest rate linked to the lender's SVR, which remains unhedged. Fitch has analysed the product switching and hedging within its cash flow analysis.

Related Appendix

[Paragon Mortgages \(No.26\) PLC – Appendix](#)

Related Criteria

[Global Structured Finance Rating Criteria \(May 2019\)](#)

[EMEA RMBS Rating Criteria \(January 2019\)](#)

[UK Residential Mortgage Rating Criteria Addendum – Residential Mortgage Assumptions \(May 2018\)](#)

For a full list of applicable criteria please see [page 19](#)

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Transaction Comparison^a

	PM26	PM25 ^b	PM24	Malt Hill No. 2	Precise Mortgage Funding 2018-2B Plc
Closing date	June 19	Apr 18	Nov 15	Jun 18	Mar 18
Total issuance (GBP)	654,648,074	705,848,000	350,110,956	356,400,000	387,580,000
WAFF (%)					
AAAsf	20.3	22.7	24.0	19.0	18.9
AAsf	16.4	18.5	19.3	15.3	15.2
Asf	12.1	13.9	14.3	11.4	11.3
BBBsf	8.2	9.7	9.7	7.7	7.6
BBsf	4.9	6.1	5.8	4.6	4.6
WARR (%)					
AAAsf	43.9	39.8	43.5	48.8	45.7
AAsf	48.8	44.2	48.4	54.1	50.9
Asf	53.7	48.6	53.2	59.4	56.0
BBBsf	58.6	53.0	58.1	64.7	61.1
BBsf	63.4	57.3	63.0	69.8	66.1
Portfolio collateral balance (GBP)	645,378,741	705,272,723	348,458,861	351,283,550	374,470,478
Number of borrowers	3,360	3,572	1,872	1,882	2,137
Av. current balance per borrower (GBP)	192,077	197,445	186,143	186,654	175,232
WA seasoning (months)	32	29	4	15	11
WA remaining term (years)	18	19	21	20	21
Loan-to-value (%)					
WA sLTV	100.6	97.7	96.5	91.5	99.5
WA OLTV	71.4	71.8	73.2	61.1	71.0
WA CLTV	70.8	71.2	73.0	60.8	70.9
OLTV >=80%	6.6	5.5	14.0	0.0	12.6
Borrower characteristics (%)					
CCJs	0.0	0.0	0.0	0.2	0.0
BO/IVA	0.0	0.0	0.0	0.0	0.0
<90 arrears	0.0	0.0	0.1	0.1	0.0
90+ arrears	0.0	0.0	0.0	0.0	0.0
WA DTI ^c	n.a.	n.a.	n.a.	n.a.	n.a.
WA ICR	90.4	96.6	84.6	96.0	105.4
Mortgage characteristics (%)					
Buy-to-let	100.0	100.0	100.0	100.0	100.0
Right-to-buy	0.0	0.0	0.0	0.0	0.0
Flexible loans	0.0	0.0	0.0	0.0	0.0
Second-charge loans	0.0	0.0	0.0	0.0	0.0
Interest-only loans	92.3	92.1	93.3	93.4	89.7
Self-employed	51.9	57.9	41.9	22.7	54.1
WA stabilised margin	4.6	4.6	4.7	4.0	4.2

^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 Ratings

Transaction Parties

Transaction Parties

Role	Counterparty	Rating
Issuer	Paragon Mortgages (No.26) PLC	n.a.
Originator	Paragon Mortgages (2010) Limited, Paragon Bank PLC	BBB/RWN/F3 (Paragon Banking Group PLC)
Sellers	Paragon Mortgages (2010) Limited, Paragon Bank PLC	BBB/RWN/F3 (Paragon Banking Group PLC)
Administrator/servicer	Paragon Mortgages (2010) Limited, Paragon Bank PLC	BBB/RWN/F3 (Paragon Banking Group PLC)
Account bank	Citibank, N.A., London Branch	A+/Stable/F1
Collection account banks	Barclays Bank plc, National Westminster Bank Plc	A+/RWN/F1, A+/RWN/F1
Principal paying agent	Citibank, N.A., London Branch	A+/Stable/F1
Swap provider	Lloyds Bank Corporate Markets plc	A/RWN/F1
Arrangers	Lloyds Bank plc, Morgan Stanley & Co. International plc	n.a.

Source: Fitch Ratings, Paragon Mortgages (No.26) PLC

Asset Analysis

Lender Adjustment

A lender adjustment of 1.0 was applied to Fitch's base foreclosure frequencies. This assumes 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 January 2019 to focus on its origination practises and servicing abilities. Paragon is an experienced lender specialising in the BTL segment and sourcing its applications primarily through 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.

Lender Strengths and Weaknesses

Paragon Mortgages Limited/Paragon Bank PLC

Strengths	<ol style="list-style-type: none"> Manual underwriting of all cases and processes and systems in place to deal with professional landlords. Strong valuation process and oversight of valuations which includes the use of Paragon's own surveyors. Full alignment to the PRA guidelines. Robust Receiver of Rent process.
Weakness	<ol style="list-style-type: none"> A focus on professional landlords which involves more complex underwriting and provides the potential for higher concentration risk.

Source: Fitch Ratings

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 lower or no rental income;
- the servicing of the loan is primarily dependent on rental income, which may be more volatile in stress periods than personal income of an employee.

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 mortgagors in arrears. Following the appointment, the ROR will directly collect rent from tenants and pass it to the lender to pay down any arrears. This helps keep a steady flow of cash to the transaction.

Receiver of Rent

Fitch believes the risk of exposure to a single borrower is mitigated to a large extent by Paragon's reliance on the ROR process. Generally, if a 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 uses a wholly owned subsidiary, Redbrick Survey and Valuation Limited (Redbrick), for the ROR process.

Paragon sends a surveyor with a property agent to the property and informs the tenant that they have to transfer 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 fully 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 76, 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, 92.3% 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 (ie 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 form 51.9% of the current balance in the preliminary pool. These are typically professional landlords who rely solely on rental income for their mortgage repayments. 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 85.5% of loans that pay a fixed rate. Of the floating loans, 7.5% are linked to Paragon's Libor, while 7.0% are linked to Paragon's SVR.

Of the loans that are paying a fixed rate of interest, 96% will revert to Paragon's SVR and 4% will revert to Paragon's Libor.

The fixed-rate loans are hedged through an interest-rate swap. Under this arrangement the issuer pays a fixed coupon and receives daily compounded SONIA from the swap counterparty. The timing difference between the fixing date for the variable rate mortgages and the notes is unhedged.

Property Type

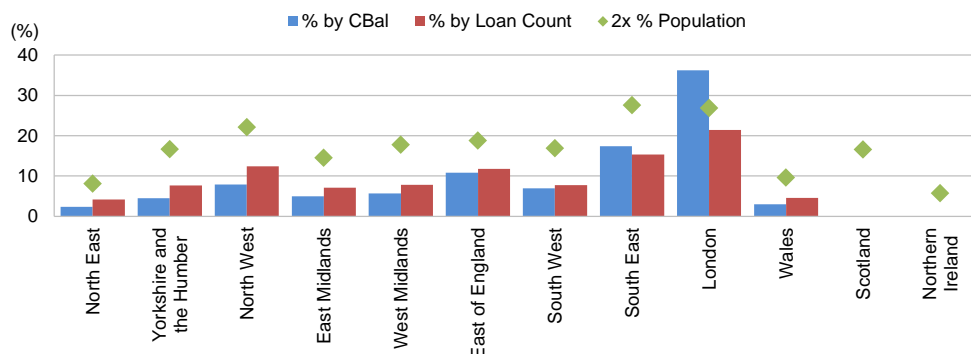
In the provisional pool, 64% of the loans are secured against houses and 31% are secured against flats with the rest classified as other.

Of the preliminary pool, 6% is classified by Fitch as illiquid, which represents property values in the top 5% of the market. This does not take into account the few cases where one larger multi-unit block is divided into several smaller flats financed by one borrower with separate mortgages.

Geographical Concentration

The provisional pool displays no geographical concentration in excess of the two times population threshold and no adjustment was therefore made.

Geographic Distribution



Source: Pool tape, Fitch

Further Advances

Up to 16% of the initial pool can be added at a later stage to the pool, alongside the mandatory further advances to existing borrowers, which are prefunded via a separate reserve at closing. Fitch did not make any adjustment based on these two types of further advances as their impact is considered limited.

ResiGlobal 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.

ResiGlobal Model Output

Rating level (%)	WAFF ^a	WARR ^b	MVD ^c
AAAsf	20.3	43.9	68.3
AAsf	16.4	48.8	64.9
Asf	12.1	53.7	61.4
BBBsf	8.2	58.6	58.0
BBsf	4.9	63.4	54.6
Bsf	3.3	68.2	51.2

^a Weighted-average foreclosure frequency

^b Weighted-average recovery rate

^c Market value decline

Source: Fitch Ratings

Financial Structure and Cash Flow Analysis

The notes will amortise sequentially even between the classes A1 and A2, although these two would rank equally post-enforcement. There is no pro rata amortisation trigger in place.

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 as further advance, 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 daily compounded SONIA.

As the swap notional is neither reflective of any prepayments nor any defaults, there is a high probability that the transaction will become over hedged. 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, where the issuer pays a fixed swap rate and receives a low SONIA rate or needs to pay for any potential SONIA. 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 A1 and A2 interest
4	Class A1 and A2 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: Fitch Ratings, Paragon Mortgages (No.26) PLC

Simplified Principal Priority of Payments

1	Principal applied to meet senior expenses deficit
2	Mandatory further advances
3	Discretionary further advances
4	Class A1 principal
5	Class A2 principal
6	Class B principal
7	Class C principal
8	Class D principal
9	Class Z principal
10	Class S principal

Source: Fitch Ratings, Paragon Mortgages (No.26) PLC

Step-Up in Margin on Notes

From the interest payment date (IPD) in August 2024, 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. The step-up margins are 1.5 times the initial margins with a cap at 1% over the initial margin. 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 margin (%)
Class A	TBD	TBD
Class B	TBD	TBD
Class C	TBD	TBD
Class D	TBD	TBD

Source: Fitch Ratings, Paragon Mortgages (No.26) PLC

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 only 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 daily compounded SONIA plus 3.0% (as calculated by the administrator and referenced to the Mortgage Margin Reserve Fund (MRF) Libor as per the transaction documentation) and thereafter funded discretionally until the step-up date. At closing, the Mortgage MRF is expected to be 0. The required amount on any subsequent 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. The monthly mortgage margin requirement is calculated to capture the shortfall between the WA

charging interest rate and daily compounded SONIA plus 3.0% for all mortgages purchased at closing and subsequent further advances taking into account any hedging for fixed-rate loans.

The monthly mortgage margin requirement is floored at zero. Fitch did not give any credit to this margin account as defaults or interest rate switches can lead to a WA margin below daily compounded SONIA + 3.0% as in every period there might not be sufficient funding for this reserve via the waterfall. 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 MRF 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 for the time period 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. Without sufficient funding of this reserve, no product switches are allowed to take place.

Further Advances and the Further Advance Pre-Funding Reserve

Further advances in the mortgage pool will take the form of either mandatory further advances or discretionary further advances. In the provisional mortgage pool, 0.2% 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 the 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 (MFA) 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:

- there is no PDL balance on the preceding IPD;
- the general reserve is at its required amount;
- the discretionary further advance must be secured on the relevant property owned by the borrower;
- the current balance of mortgages that are more than three-months plus in arrears is less than 2.0%;
- the borrower is not in breach of the mortgage conditions;
- the CLTV did not exceed 75.0% on the immediately preceding principal determination date;
- the current balance of the 20 largest borrowers did not exceed GBP40 million on the last principal determination date;
- 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

The notes are amortising in a strictly sequential manner without any potential pro rata amortisation. Prior to any potential enforcement, the class A1 notes are repaid before the class A2 notes, but classes are ranking equally in case of any enforcement event.

Hedging and Interest Rate Risk

The notes in the transaction are linked to SONIA. Therefore, an interest rate risk arises from the fixed paying assets.

The preliminary pool consists of 85.5% of fixed-rate loans, of which 96% revert to Paragon's SVR and 4% to 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 2.1 years with the longest fixed-rate period being 5.0 years. Product switches can take place solely, when the weighted average life of fixed-rate loans times the share of fixed rate loan is below two years.

The basis risk between the SVR loans and daily compounded SONIA 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 daily compounded SONIA in a rising interest rate scenario is 3.0%. For the stable and decreasing interest rate scenarios, Fitch assumed the spread to daily compounded SONIA to be the current margin, minus 50bp.

In the stable and decreasing interest rate scenarios, Fitch applies a 50bp cut in the margin over the daily compounded SONIA. In the rising interest rate scenario, Fitch assumes an SVR margin of 2%-3% based on a comparison of the lender's SVR against peer lenders. Paragon's SVR is at the higher end compared to its peers; therefore, a 3.0% margin over the daily compounded SONIA was applied.

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 compounded SONIA. Further swaps will be added with a minimum denomination of GBP10 million in case mortgages switch to fixed rates, while in cases of defaults and prepayments of fixed-rate mortgages, the swap notional might be partly cancelled in case sufficient revenue funds are available.

Additional Fixed-Rate Loans

Additional fixed-rate loans added to the transaction, through product switches or further advances 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 agreements 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 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.

Moreover, prepayments on fixed-rate loans are not economical for borrowers as those incur prepayment penalty fees. 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 below the limit of GBP10 million on three specified dates before the step-up date in order to be able to continue with interest rate conversions. Between these dates, Fitch assumed that the issuer might not have enough funds to cancel any swap notional not needed based on defaults and prepayments

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

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, decreasing interest rates and a front-loaded default distribution was the most detrimental to the class A notes.

Rating Sensitivity¹

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. 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.

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.

Rating Sensitivity to Defaults

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

Source: Fitch Ratings

Rating Sensitivity to Recovery Rates

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

Source: Fitch Ratings

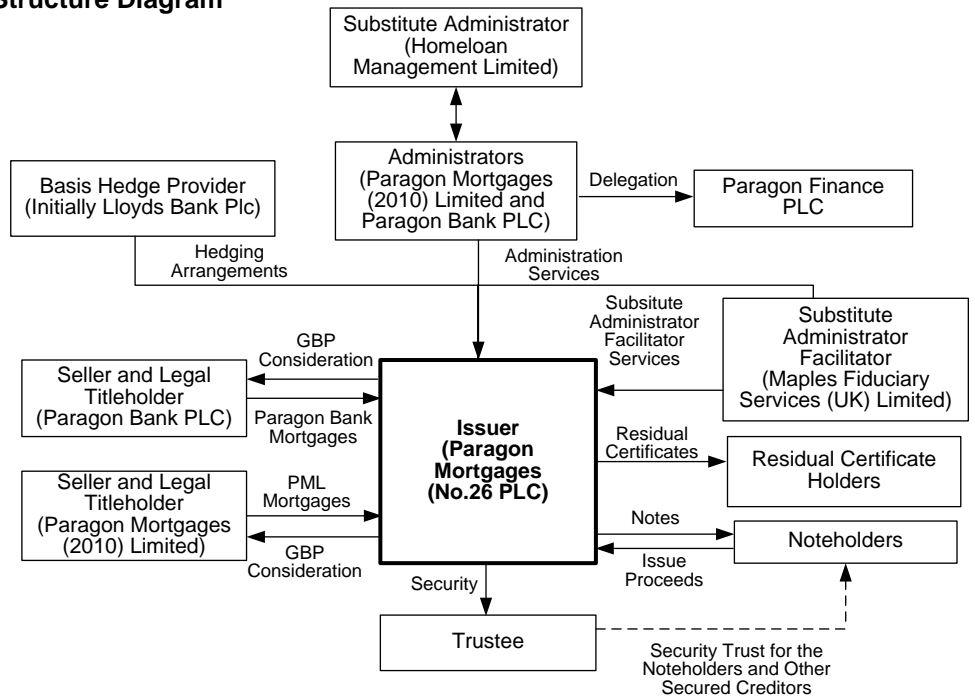
Rating Sensitivity to Defaults and Recovery Rates

	Class A	Class B	Class C	Class D
Original rating	AAAsf	AAsf	Asf	BBBsf
Default rate increase of 15%, recovery rate decrease of 15%	AA+sf	A+sf	BBB+sf	BBB-sf
Default rate increase of 30%, recovery rate decrease of 30%	AA-sf	A-sf	BBBsf	BB+sf

Source: Fitch Ratings

Transaction and Legal Structure

Structure Diagram



Source: Fitch Ratings

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 R&W can be found in the related Appendix, at www.fitchratings.com.

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 31 May 2045;
- 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

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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, Maples 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

Paragon provided Fitch with a loan-by-loan-level data template. The data quality and availability were 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 5,080 sold repossessions between 2003 and 2018. Fitch concluded to use its criteria values for the market value decline (MVD) estimation as the data provided by the seller/originator is biased towards house price performances in certain time periods.

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 practices 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 60 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 these daily sweeps, Fitch judges the commingling risk as immaterial.

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 daily compounded SONIA. The swap provider for the initial swap is Lloyds Bank Corporate Markets Public Limited Company, rated 'A/RWN/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.

Surveillance

Fitch will monitor the transaction as per the *EMEA RMBS Rating Criteria*. Details of the transaction's performance will be available to subscribers at www.fitchratings.com.

Applicable Criteria

Publication

General structured finance and sector specific rating criteria

Global Structured Finance Rating Criteria	May 2019
EMEA RMBS Rating Criteria	January 2019
Structured Finance and Covered Bonds Country Risk Rating Criteria	October 2018

Counterparty risk criteria

Structured Finance and Covered Bonds Counterparty Rating Criteria	April 2019
Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum	April 2019

Interest rate stress criteria

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria	March 2019
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Country-specific criteria

UK Residential Mortgage Rating Criteria Addendum – Residential Mortgage Assumptions	May 2018
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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 Ratings

Appendix A: Origination and Servicing

Originator Overview

Originator	Paragon Mortgages (2010) Limited, Paragon Bank plc
Assessment date	January 2019
Total lending volume	GBP10,473,500,000
Product mix (total book)	98.0% first charge BTL 0.7% first charge owner-occupied

Source: Fitch Ratings, Paragon

Current Staffing

Total number of origination employees	160
Total number of servicing employees	150
Average industry experience (senior management)	15+

Source: Fitch Ratings, 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 five-year fixed-rate mortgages, the higher of pay rate and 4.0%

Source: Fitch Ratings

Company Overview

Paragon Bank is a subsidiary of the Paragon Banking Group PLC (BBB/RWN/F3), which provides various financial products to consumers. Paragon specialises in the origination of 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 GBP10.26 billion as at 30 September 2018 (2017: GBP9.84 billion). The group's new BTL lending increased by 6.8% yoy 2017 to 2018.

Paragon also originates second-charge loans and owner-occupied mortgages. 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 disciplinarys. 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 generate workflow that automatically appears in the underwriter's 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 the 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	80	1,000,000	80	5,000,000
3	700,000	80	700,000	80	2,000,000
4	400,000	80	400,000	80	1,000,000
5	200,000	80	200,000	80	750,000
6	100,000	80	100,000	80	250,000

Source: Fitch Ratings

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 any automated valuation models.

Valuation reports are valid for three months. If the valuation is older than three months then a Paragon surveyor has the ability to review the valuation and if appropriate extend it to a maximum of three months. If the valuation is =>five 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 pay down 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.

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