



RATING ACTION COMMENTARY

Fitch Upgrades Paragon Mortgages (No. 27) and Paragon Mortgages (No. 28)

Wed 21 Sep, 2022 - 1:04 PM ET

Fitch Ratings - London - 21 Sep 2022: Fitch Ratings has upgraded Paragon Mortgages (No. 27) PLC's class B notes and Paragon Mortgages (No. 28) PLC's class D notes. In addition, Fitch has removed the notes, except for class A, from Under Criteria Observation (UCO) as detailed below.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
Paragon Mortgages (No. 27) plc		
A XS2132036737	LT AAAsf Rating Outlook Stable Affirmed	AAAsf Rating Outlook Stable
B XS2132137337	LT AAAsf Rating Outlook Stable Upgrade	AA+sf Rating Outlook Stable

C XS2132137410	LT	A+sf Rating Outlook Stable	A+sf Rating Outlook Stable
		Affirmed	
D XS2132137683	LT	BBB+sf Rating Outlook Stable	BBB+sf Rating Outlook Stable
		Affirmed	
Paragon Mortgages (No. 28) PLC			
A XS2243463879	LT	AAAsf Rating Outlook Stable	AAAsf Rating Outlook Stable
		Affirmed	
B XS2243463952	LT	AA+sf Rating Outlook Stable	AA+sf Rating Outlook Stable
		Affirmed	
C XS2243464091	LT	A+sf Rating Outlook Stable	A+sf Rating Outlook Stable
		Affirmed	
D XS2243464174	LT	BBB+sf Rating Outlook Stable	BBBsf Rating Outlook Stable
		Upgrade	

[VIEW ADDITIONAL RATING DETAILS](#)

TRANSACTION SUMMARY

The transactions are the 27th and 28th from the Paragon series consisting of buy-to-let (BTL) mortgages originated by Paragon Mortgages (2010) Limited, Paragon Bank plc and other members of the Paragon Banking Group.

KEY RATING DRIVERS

Upgrades Reflect New Criteria: The upgrades reflects Fitch's application of its latest UK RMBS Rating Criteria published on 23 May 2022, under which the agency has

updated its sustainable house prices for each of the 12 UK regions. The changes resulted in increased regional multiples for all regions other than the north east and northern Ireland. The criteria also include updated house price indexation and gross disposable household income. The sustainable house prices are now higher in all regions except northern Ireland. This has had a positive impact on recovery rates and, consequently, Fitch's expected loss and contributed to the upgrades.

Stable Asset Performance: Asset performance has remained strong, with arrears by more than one monthly payment at 0% (Paragon 27) and 0.11% (Paragon 28) as of June and May 2022, respectively. Given the BTL nature of the underlying pool, borrowers in arrears by more than two months are predominantly managed by Paragon via its receiver of rent policy, where the full rental stream is diverted to Paragon, as administrator, and used towards clearing arrears. Paragon's extensive use of its receiver of rent policy has therefore contributed towards the low level of delinquencies across the series. Prepayments for both transactions have not peaked at as high levels as previous Paragon transactions, as the pools are still mostly on a fixed rate.

Interest-Rate Mismatch Hedged: The pools backing the transactions are predominantly paying a fixed rate of interest, 96.8% and 97.8%, respectively, for Paragon 27 and 28, (before reverting to Paragon's standard variable rate (SVR) or discounted SVR), while the notes pay a compounded daily SONIA-linked floating rate. The issuer entered a swap at closing to mitigate the interest-rate risk arising from the fixed-rate mortgages in the pools. The swap features a defined notional balance that was derived to reflect the interest-rate reset dates of the mortgage pool.

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 interest-rate mismatch hedges.

Interest-Only Concentration: Both transactions have a material concentration of interest-only (IO) loans maturing within a three-year period during their lifetime, peaking at 55.3% during 2042-2044 for Paragon 27 and at 57.5% during 2043-2045 for Paragon 28. Where a concentration is present, Fitch will derive IO concentration's weighted average foreclosure frequency (WAFF) and apply in the analysis the higher of IO concentration WAFF and the standard portfolio WAFF for each rating level. For these pools Fitch has applied the FF based on the IO concentration WAFF.

Desktop Valuation Adjustment: The Paragon 28 pool includes 9.6% of properties valued at origination through a desktop valuation during the first 2020 lockdown when

physical valuations were not allowed. A desktop valuation process was conducted by Paragon's in-house team of regional surveyors, restricted to a limited number of non-complex properties with up to four tenants sharing. Fitch notes that a rigorous process has been put in place and that desktop valuations have only been applied to a minority of the total originations, representing a limited number of cases. For this reason, Fitch has applied a 0% adjustment to the desktop valuations in this pool (instead of the 5% standard adjustment) in line with its criteria.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The transactions' performance may be affected by changes in market conditions and economic environment. Weakening economic performance is strongly correlated to increasing levels of delinquencies and defaults that could reduce credit enhancement available to the notes.

Additionally, unanticipated declines in recoveries could also result in lower net proceeds, which may make certain note ratings susceptible to negative rating action, depending on the extent of the decline in recoveries. Fitch conducts sensitivity analyses by stressing both a transaction's base-case FF and recovery rate (RR) assumptions, and examining the rating implications for all classes of issued notes. Fitch tested a sensitivity scenario by applying 15% increase in the weighted average (WA) FF and a 15% decrease in the WARR. The results indicated downgrades of up to three notches for both transactions.

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

Stable to improved asset performance driven by stable delinquencies and defaults would lead to increasing credit enhancement levels and, potentially, upgrades. A decrease in the WAFF of 15% and an increase in the WARR of 15% indicates upgrades of no more than one notch for both transactions.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Structured Finance transactions have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of seven notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of seven notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAAsf' to 'Dsf'. Best- and worst-case scenario credit ratings are based on historical

performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>.

USE OF THIRD PARTY DUE DILIGENCE PURSUANT TO SEC RULE 17G -10

Form ABS Due Diligence-15E was not provided to, or reviewed by, Fitch in relation to this rating action.

DATA ADEQUACY

Fitch has checked the consistency and plausibility of the information it has received about the performance of the asset pools and the transactions. Fitch has not reviewed the results of any third-party assessment of the asset portfolio information or conducted a review of origination files as part of its ongoing monitoring.

Prior to the transactions closing, Fitch reviewed the results of a third-party assessment conducted on the asset portfolio information and concluded that there were no findings that affected the rating analysis.

Overall, and together with any assumptions referred to above, Fitch's assessment of the information relied upon for the agency's rating analysis according to its applicable rating methodologies indicates that it is adequately reliable.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entities. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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APPLICABLE CRITERIA

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

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

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

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

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

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

APPLICABLE MODELS

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

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

ResiGlobal Model: UK, v1.4.0 (1)

ADDITIONAL DISCLOSURES

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ENDORSEMENT STATUS

Paragon Mortgages (No. 27) plc

UK Issued, EU Endorsed

Paragon Mortgages (No. 28) PLC

UK Issued, EU Endorsed

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