

RMBS/UK Presale Report

Paragon Secured Finance (No. 1) PLC

Expected Ratings*

Class	Amount (GBPm)	Final Maturity	Rating	CE (%)
A	231	2035	AAA	27.50
B	42	2035	A	13.50
C	27	2035	BBB	4.50

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* Expected ratings do not reflect final ratings and are based on provisional pool information provided by the issuer as of 2 December 2004.

■ Summary

This GBP300 million transaction is a securitisation of second-charge mortgage loans in the UK predominantly for the purpose of debt consolidation with the proceeds often used for home improvements, auto purchase or other general reasons. Fitch Ratings has assigned expected ratings to the notes to be issued by Paragon Secured Finance (No. 1) PLC (the “issuer” or “PSF1”) as indicated at left.

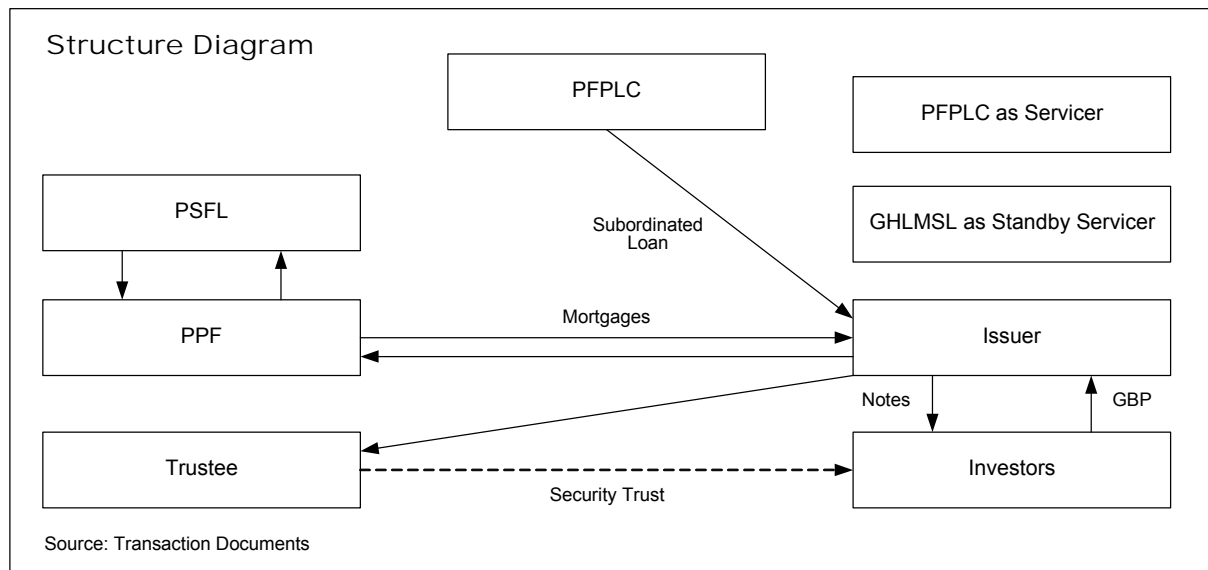
The expected ratings are based on the quality of the collateral, available credit enhancement, the underwriting processes of Paragon Personal Finance Limited (“PPF”), as well as the servicing capabilities of Paragon Finance PLC (“PFPLC”) Both entities are wholly owned subsidiaries of The Paragon Group of Companies (“the Group”). The expected ratings are also based on the capabilities of GHL Mortgage Services Limited (“GHLMSL”) as stand-by administrator and the sound legal structure of the transaction. Credit enhancement for the class A notes will be provided by the subordination of the class B notes (14%), the class C notes (9%) and a reserve fund of 4.50%, which will be fully funded at closing. The reserve fund will build up to 5.30% on the breach of certain arrears triggers (See *Reserve Fund* Below).

Some 48.8% of the provisional pool will consist of loans originally part of the trust property for Paragon Auto and Secured Finance (No. 1) PLC, which closed in November 2000 and was called in November of this year. The Group offers an array of financial products, ranging from personal, retail point of sale and auto loans to prime residential mortgages. All the loans in the provisional mortgage pool were originated by PPF. This is the Group’s first transaction almost entirely consisting of loans secured by second-charge mortgages and, indeed, is the first such transaction in the UK RMBS market since 1998.

To determine appropriate credit enhancement levels, Fitch analysed the collateral using its UK Residential Mortgage Default model as a benchmark and adjusted it to account for additional risks associated with buy-to-let lending (see “*UK Residential Mortgage Default Model II*” of 13 October 2000, available at www.fitchratings.com). Fitch also modelled the cash flow contribution from excess spread using its European RMBS cash flow model (see “*European RMBS Cash Flow Criteria*” of 20 December 2002, available at www.fitchratings.com) using the default and recovery assumptions indicated by the default model. The cash flow test showed that each class of rated notes could withstand loan losses at a level corresponding to the related stress scenario without incurring any ultimate principal loss or interest shortfalls on interest payment dates.

Special Reports

The following special reports provide additional detail on the Fitch rating approach to, and performance of, the RMBS market; all are available at www.fitchratings.com:



- “UK Residential Mortgage Default Model II”, 13 October 2000
- “A Guide to European RMBS Cash Flow Analysis”, 20 December 2002
- “UK Non-Conforming RMBS: Performance Reviewed 3Q04”, 22 November 2004

■ Credit Committee Highlights

- The first Paragon transaction composed almost entirely (98.88%) of second-charge mortgage loans in the UK (see *Collateral*). 95.0% of the loans were offered for the purpose of debt consolidation, to some extent.
- Second-charge loans generally have a much higher loss severity owing to prior-ranking mortgage claims. In its default analysis, Fitch assumes that recoveries on second-charge loans are limited to the amounts (including the related carry costs) remaining after all prior-ranking charges and associated recovery costs have been repaid.
- The weighted average combined original loan-to-value (“OLTV”) is almost 89%, while 52.01% of the pool has an OLTV higher than 90% (28.03% has an OLTV over 100%). The weighted average OLTV of prior charges is 59.40%. PPF’s underwriting criteria allow for a maximum potential combined OLTV of 160%, including fees and insurance premiums.
- Historical performance to date has been exceptional, with static levels of arrears over 90 days reaching a peak of only 2.25% for loans originated in the first quarter of 2000. However, this has been during a period of high prepayments, so the arrears performance has not

been observed through a full life-cycle of the loans.

- Borrowers who get into difficulties in paying their loan may refinance with more aggressive subprime lenders (which would act as a brake on Paragon’s arrears figures). In a downturn, such refinancing options will probably become limited, causing prepayments to fall back and such distressed borrowers to be retained in the portfolio. While prepayments have been very high, averaging around 30% in the last 12 months, Paragon’s figures suggest that only around 5% of borrowers were in arrears when they prepaid, which indicates that few are refinancing with subprime lenders as a result of financial difficulty.
- Relatively low geographical concentration of properties located in London, the Outer Metro Area and the South East (29.51%). The agency’s market value decline (“MVD”) assumptions are at their highest in these areas.
- The transaction structure provisions 100% via the principal deficiency ledger (“PDL”) for loans defined as more than 12 months in arrears. This diverts excess spread to repay principal on loans in serious arrears, potentially before their workout is completed.
- Some loans offer rebates following full repayment of the loan. Borrowers are also able to take out payment protection and life cover in respect of their loan, while some may also enjoy a rebate of premiums on maturity of these policies. Legal analysis confirms that, should PPF default, this obligation to provide a rebate of the premium will not fall to the issuer

Key Information

Structure

Issuer: Paragon Secured Finance No 1 PLC (“PSF1”).

Lead Manager: Barclays Capital

Originator: Paragon Personal Finance (“PPF”)

Trustee: Citicorp Trustee Company Limited

Paying Agent: Citibank N.A. (‘AA+/F1+’)

Mortgage Administrator & Servicer: Paragon Finance PLC (“PFPLC”)

Stand-by Mortgage Administrator: GHLMortgage Services Limited (“GHLMSL”)

Account Bank: National Westminster Bank (‘AA+/F1+’)

Interest Payments: Quarterly in arrears, starting on 15 May 2005 and thereafter on the 15th day of August, November, February and May in each year.

Legal Maturity: November 2035

Optional Redemption: In November 2008 or any payment date thereafter, or clean-up call when 20% or less of the original principal balance is outstanding.

Provisional Pool Characteristics
Based on Provisional Pool Dated
30 September 2004

Total Amount: Approx GBP241.2m (10,884 loans)

WA Original LTV: 88.78%

WA Indexed Current LTV*: 83.88%

WA Prior Charge LTV: 59.40%

WA Current Interest Rate: 9.44%

WA Remaining Maturity: 187.80 months

WA Seasoning: 9.89 months

Repayment: 100%

* Based on Nationwide regional indices, giving 50% credit to upward movements in such indices.

because only the benefit of the contract is being assigned. (See *Rebates and Set off* below for a further discussion of legal risks associated with the PPP policies).

- The transaction includes a four-year revolving period, during which principal redemptions can be reinvested in new mortgage loans subject to compliance with certain conditions and limitations (See *Replenishment* below).
- Some 98.25% of the pool is linked to the variable rates set independently by PPF. The

basis risk between the variable rates received on the loans and the three-month LIBOR paid to the notes will not be hedged at closing, but is addressed by the threshold interest margin described below. Fitch sized for this risk in its analysis. The remaining 1.75% are fixed rate and will not be hedged. To protect the structure against an increase in fixed-rate risk during the revolving period, the unhedged fixed-rate exposure is limited to a maximum of 4%, at which point a specific hedge will be contracted.

- Paragon has adopted a threshold interest margin mechanism in this transaction designed to ensure that the weighted average contractual margin over three-month LIBOR (including income/expense from hedging (if put in place at some point post-closing), investments and redemptions) on the reference portfolio as a whole will be at least 4.5%. Should the weighted average margin fall below these levels, the mortgage administrator will, under the mechanism, be obliged to increase the rates on variable-rate loans in the pool. Fitch has stressed the threshold interest margin rate that is achieved in its ‘AAA’ analysis. At this ‘AAA’ level, Fitch has also stressed the potential mismatch between the fixed and variable tracker loans, which has reduced the excess spread available to the transaction in such scenarios.
- For approximately 12% of the loans (by value and 23% by number), the valuation data provided was based on an indexed valuation rather than a third-party physical valuation. In such cases, PPF bases its valuation figures on the CML index and applies 100% of any increase over the values determined by a physical valuation for remortgages from the past five years or purchases from the last 10 years. Given the less precise nature of indexed valuations, Fitch has applied a haircut to the value of certain of these loans in its analysis.
- As at closing, approximately 25% of the principal raised through the note issuance will be retained in the transaction account and applied on the first payment date towards the purchase of further loans (pre-funding). This retention of funds will result in a lower return than if the funds were invested in higher-yielding mortgages, thereby creating negative carry for the transaction during the first interest period. The first interest payment date is in May 2005. Pre-funding loans will be subject to credit analysis by the agency prior to their purchase to ensure that their credit quality is consistent with that of the portfolio at closing.

■ Credit Structure

The financial structure of the transaction is designed to provide differing degrees of credit enhancement to the note tranches. The class A notes are protected firstly by any excess spread, secondly, by the reserve fund (4.50%) and thirdly by the subordination of the class B (14%) and C notes (9%). The notes will initially be repaid in sequential order and subsequently *pro rata*, subject to compliance with certain conditions (See *Principal Redemption* below).

The reserve fund will also be available to cover interest shortfalls and losses, subject to certain restrictions on paying interest on the subordinated notes. The reserve fund will increase further to 5.30% in the event that a certain level of arrears is exceeded (see *Reserve Fund* below).

Available residual excess spread will be used to replenish the reserve fund (if drawn) to its required amount on every payment date before the remainder returns to the originator.

Revenue Priority of Payments

Payments received by PSF1 will be split into revenue and principal and will, subject to certain exceptions (see *Principal Used for Senior Interest Liquidity*), be paid via separate waterfalls. All revenue received on the issue (eg borrower interest payments, swap payments (if any) and interest earned on cash in the collections accounts prior to the interest payment date) will be applied on each payment date according to the following priority of payments:

1. trustee and substitute servicing fees;
2. servicer fees;
3. *pro rata* amounts due and payable as interest to the class A noteholders and payments to the swap provider (if any swaps are put in place post-closing);
4. amounts due and payable as interest to the class B noteholders;
5. amounts due and payable as interest to the class C noteholders;
6. VAT to be paid, if any;
7. amounts applied to extinguish a debit balance on the PDL;
8. amounts required to replenish the reserve fund;
9. other subordinated amounts, including a provision for a reserve to fund any purchase of caps and other hedging instruments in the next period.

Should the debit balance recorded on the PDL exceed the balance of then-outstanding class C notes, a PDL amount to the extent of that excess would be applied and replenishment of the reserve fund would

occur prior to item (5). Should the debit balance recorded on the PDL exceed the balance of both the then-outstanding class B and class C notes, a PDL amount to the extent of that excess would be applied and replenishment of the reserve fund would occur prior to item (4).

This will ensure that any PDL debit balance corresponding to the more senior notes will be reduced to zero before interest is paid on subordinate notes.

Principal Used for Senior Interest Liquidity

Principal receipts may be used to pay interest on the class A notes in the event that it cannot be paid from excess spread and amounts in the reserve fund. The PDL will be debited by the amount used to pay senior interest. This debit balance will then be repaid at the relevant position in the revenue priority of payments using available revenue.

Principal Redemption

Mandatory

All amounts recorded as principal (including scheduled repayments, prepayments, amounts credited to the PDL and defaulted loan sale proceeds) other than in respect of senior interest shortfalls not covered by revenue funds or further advances extended during the previous period, will initially be passed through to noteholders sequentially, first to Class A, then Class B, then Class C.

However, once the following conditions have been met, amortisation will be *pro rata* to maintain the then-current ratio of B and C notes to senior notes:

- the balance of junior notes as a proportion of the total outstanding balance of notes exceeds two times that at closing;
- it is after November 2009;
- there is no debit balance on the PDL;
- the balance of loans over three months in arrears is less than 10% of the then-current balance; and
- the outstanding balance of class B notes and class C notes is more than 4.76% of the original principal balance;

Optional

At the option of the issuer it is possible to redeem all the class A, B and C notes at their respective outstanding principal amounts plus accrued interest in the following circumstances:

- on or after the interest payment date in November 2008;

- if the then-current outstanding principal amount is less than 20% of the original principal balance;
- if the issuer is required to make any withholding tax deductions.

Fitch's expected ratings do not address the possible exercising of these call options held by the issuer.

Final

To the extent not previously paid down, the class A notes, the class B and C notes are due to be redeemed in full in November 2035.

Replenishment

The issuer will be entitled to purchase further mortgages at any time up to and including the interest payment date in November 2008 if the loans comply with the eligibility criteria and in the following circumstances:

- the aggregate amount of mandatory further advances is not higher than GBP5m;
- the balance of loans over three months in arrears is less than 10% of the then-current balance;
- aggregate interest payments received from borrowers in respect of all mortgages during the three-month period ending on the immediately preceding principal determination date are 95% or more of the aggregate that fell due for payment by borrowers in respect of all mortgages in such period;
- there is no debit balance on the PDL;
- the reserve fund balance is at its required amount;
- the product of the weighted average foreclosure frequency ("WAFF") and the weighted average loss severity ("WALS") for the mortgages which are current or less than 12 months in arrears does not exceed the product of the WAFF and WALS plus 0.25% for the mortgages as calculated on the closing date
- on the provision, by each of the issuer, PPF and PFPLC, of solvency certificates, each dated on the date of such purchase, signed by an authorised officer of the relevant company.

Interest Rate and Basis Risk

Some 98.25% of the portfolio is charged against variable rates set by PPF. The potential mismatch between three-month LIBOR to be paid on the notes and the variable rates to be paid on the underlying loans will not be specifically hedged within the transaction. Similarly, the potential mismatch between the three-month LIBOR basis for the notes and the underlying PPF loans, based on when their reset dates occur each quarter, is not specifically

hedged. There are no three-month LIBOR loans in the provisional pool.

Instead, Paragon has adopted a threshold interest margin ("TIM") mechanism for this transaction, designed to ensure that the weighted average contractual margin over three-month LIBOR on the reference portfolio as a whole (including income/expense from hedging (if put in place post-closing), investments and redemptions) will be at least 4.5%. Should the weighted average margin fall below these levels, the mortgage administrator will, under the mechanism, be obliged to increase the variable rates on the pool, or ensure that there are sufficient monies in a shortfall fund to support the difference. Fitch has stressed the threshold interest margin rate that is achieved in its 'AAA' analysis.

At closing, some 1.75% of the loans in the provisional pool will have a fixed rate of interest until January 2014 at the latest and this portion will not be hedged. Substitution of loans during the revolving period could increase the proportion of fixed-rate loans. The documents also allow for the possible future inclusion of LIBOR-linked or Base Rate tracker mortgage loans during the revolving period.

To protect the structure against an increase of fixed-rate, LIBOR or base rate tracker risk during the revolving period, the proportion of unhedged fixed-rated loans is limited to a maximum of 4%, above which specific hedging arrangements need to be put into place. Moreover, should PPF begin to originate LIBOR-linked and base rate tracker loans, it will only be possible to substitute such loans into the portfolio if they do not cause the minimum threshold interest margin to be breached (not including monies in the associated shortfall fund). This is required because, if fixed, LIBOR or base rate based mortgages rise beyond a certain level, the TIM mechanism would be difficult to operate since these loans, unlike variable-rate loans, have prescribed rates that cannot be varied.

Swap Counterparty Rating Requirements

Although no basis risk swap agreement will be contracted by the issuer at closing, the issuer may contract some such agreements during the life of the transaction. In that case, the basis swap counterparty must be rated 'F1' and 'A', and the currency counterparty must be rated at least 'F1' and 'A+'. In the event of a downgrade of any counterparty below either of these levels, the counterparty will be required to collateralise any exposure, obtain a guarantee from a suitably rated counterparty or find a suitably rated replacement provider.

If any of the counterparties are then downgraded below 'F2' or 'BBB+', the counterparty will need to be replaced by or obtain a guarantee from a suitably rated counterparty. At this level, it will only be possible to post collateral to support the swap if the mark-to-market calculations and the correct and timely posting of collateral are verified by an independent third party.

If any of the counterparties are then further downgraded, the swap counterparty will need to be replaced by or guaranteed by a suitably rated counterparty.

Please see the report "*Counterparty Risk in Structured Finance Transactions: Swap Criteria*" dated 13 September 2004 and available at www.fitchratings.com for additional information on Fitch's criteria for such swaps.

Pre-Funding

The issuer has the right to purchase further mortgages up to 30 April 2005 (the first principal determination date), using funds from the proceeds of the notes set aside at closing and credited to the pre-funding ledger. Fitch must confirm that any pre-funded loans will not adversely affect the rating of the notes before they are included within the reference portfolio. At the first principal determination date, any balance which remains to the credit of the pre-funding ledger and was not used to purchase mortgages will be used to credit the principal ledger and will then, in turn, form part of the calculation of available redemption funds. The negative carry resulting from funds in the pre-funding ledger was incorporated into the cash flow modelling for all tranches.

Non-Verified Loans

As at the date of closing, all the loans will have made their first payment. Loans to be purchased after closing with the pre-funding amount will also be required to have made their first payment.

Credit Enhancement and Liquidity

Reserve Fund

The reserve fund of GBP13.5 m (4.50% of the issue) will be fully funded on Day 1 via a subordinated loan advanced by PFPLC. The reserve fund will further increase to 5.30% if either of the following two triggers is breached:

- the balance of loans over three months in arrears is less than 10% of the then-current balance;
- aggregate interest payments received from borrowers in respect of all mortgages during the three-month period ending on the immediately

preceding Principal Determination Date are 95% or more of the aggregate interest that fell due for payment by borrowers in respect of all mortgages in such period.

Any drawings of the reserve fund (to cover losses or revenue shortfalls) will be replenished using available excess spread. The fund has been sized by Fitch to ensure that the notes have sufficient credit protection and liquidity support to merit their respective ratings.

Excess Spread

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

Furthermore, high prepayment rates on the portfolio as a whole would squeeze the gross amount of credit enhancement available over the course of the transaction. To take account of these factors in its cash flow modelling, Fitch applied its performance assumptions (derived from the collateral model) in conjunction with stressed prepayment rates and a compressed weighted average coupon according to rating scenario (Fitch's approach to modelling cash flow in RMBS transactions is further discussed in Appendix One and in the criteria report "*A Guide to Cash flow Analysis for RMBS in Europe*" dated 20 December 2002 and available at www.fitchratings.com).

■ Collateral Analysis

Some 98.88% of the provisional pool analysed consisted of second-charge mortgage loans in the UK. All the loans were originated by PPF, and are almost entirely for debt consolidation purposes. The portfolio had a total outstanding balance of approximately GBP241.2m as at 30 September 2004. (For more product details see *Origination* below). The majority of the loans (GBP161m or 66.9% of the provisional pool) have associated payment protection policies that provide loss-of-earnings insurance (see *Set-Off Risk* below).

On or before the first interest payment date on 15 May 2005, further loans will be purchased using the retained pre-funding amount. The distinguishing

characteristics of the portfolio are detailed below, together with commentary on any special considerations. All percentages are based on the current balance of mortgages unless otherwise stated.

Repayment Type

The pool includes no interest-only loans. All the loans pay interest and repay principal on a regular monthly basis.

Arrears Loans

In the provisional pool, 2.97% of loans by current balance are currently more than 30 days in arrears, of which 1.16% are over 90 days in arrears. Fitch assumes that loans in arrears are more likely to go into default and applies conservative default adjustments to these.

The transaction structure will also provision 100% for loans defined as more than 12 months in arrears.

Conversion

The reference portfolio does not include any loans with a conversion option because PPF has not so far offered these kinds of products. However, in the context of additional further mortgages and subject to certain conditions, the Administrator may approve borrower requests to convert certain aspects of their mortgages – for instance a switch from a variable-rate loan to fixed- or capped-rate product. To approve this change, the issuer would have to obtain the necessary cash in advance to be in a position to extend the then-current hedging facilities. This would be achieved either by trapping excess spread in advance or by obtaining a loan from PFPLC, whose subsequent claim would be in a subordinated position in the revenue waterfall.

Further Advances

Mandatory further advances may be made to borrowers who have the right to obtain a further advance upon the completion of certain refurbishments to their properties. There are, however, no mandatory further advances in the provisional pool. Discretionary further advances may be agreed and advanced to borrowers in the pool by, and at the discretion of, the administrator (acting on behalf of the issuer) using principal receipts or recoveries, provided that:

- there was no debit balance on the PDL as at the previous interest payment date;
- the aggregate of: (i) the issuer's maximum potential obligation – at closing – to fund mandatory further advances; and (ii) the maximum balance of discretionary and mandatory further advances made or being considered, is GBP15m;

- the maximum amount for mandatory further advances is GBP5m;
- the reserve fund is at its required amount;
- the further advances comply with the eligibility criteria.

Rebates and Set-Off

Many of the mortgages have associated Payment Protection Policies ("PPP"), providing loss-of-earnings insurance (GBP161m). Some also have provisions for rebates of either interest paid or PPP premiums paid.

- **Loyalty Reward Schemes:** PPF now offers the option of Loyalty Reward products for 10- and 15-year loans, whereby customers can receive either one-third, or one-quarter of the full interest paid over the term of the loan, subject to certain criteria. The reward is subject to a number of conditions, one of which is that the payment is not due until the loan reaches the end of its life without prepayment. According to legal analysis performed, the obligation to make such rebates would not pass to the issuer together with the assignment of the benefit of the loan.
- **Payment Protection and Life Cover:** Five- and 10-year PPP cover is available to borrowers, and some 66.9% of borrowers have taken it out. The policies are provided by Norwich Union ("NU"), on whose behalf PPF collects premiums. According to the transaction legal opinion, a risk of set-off exists for the loans that relate to a PPP policy and are also CCA regulated, which form 19.9% of the provisional pool, as PPF will be jointly liable for payments under the PPP policy. As a result, if Norwich Union, the PPP provider, failed to pay under the policies – for example if it were insolvent – PPF would be obligated to make such payments. If PPF failed to make such payments – for example if it were insolvent – the borrower would have the right to set off such amounts against payments on their mortgages. However, this right of set-off would end upon notification of the borrowers of the assignment of the loans to the Issuer, which would occur upon PPF's insolvency. As a result, the risk to the transaction would only arise during the period after a default of both Norwich Union and PPF, and before borrowers were notified of the asset sale, which is likely to occur directly upon PPF's insolvency.
- **PPP Premium Rebate:** Under these policies PFPLC would provide a rebate of premiums paid subject to certain conditions. According to

legal analysis performed, no right of set-off would arise if the rebate were not paid by PFPLC, since this is a separate entity from PPF, the originator of the loans. Only 61 loans with a value of GBP1.4m currently enjoy this benefit.

■ Legal Structure

The PSF1 legal structure is designed to ensure that a seller insolvency would not interrupt timely payments of principal and interest to investors.

On the closing date, the loan sellers will assign the rights, title and interest in and to the mortgages to PSF1 (a public company incorporated under the laws of England and Wales). There will be no recourse to the sellers, so that the transfer to PSF1 will be treated as a true sale.

At closing, PSF1 will enter into a deed of charge, creating security over the collateral in favour of the trustee as security for all payments under the notes. The security includes second-lien mortgages and second fixed charges in favour of the trustee on all the issuer's rights, claims, title, benefit and interest in and to the underlying collateral.

Representations and Warranties

The mortgage sale agreement contains representations and warranties given by PFPLC in relation to the pool of mortgages. No search of title will be conducted by the issuer or the trustee, which will, instead, rely on such representations and warranties. If there is an irremediable breach of any of the representations or warranties, the seller will be required to repurchase the loan(s) in question.

Specifically, the representations and warranties include those detailed below.

- Each mortgage constitutes a second-ranking legal mortgage or a second-charge mortgage, and PPF is the holder of the second charge, which is a valid and binding obligation of the borrower, enforceable under its terms.
- No lien or right of set-off exists between the borrower and the originator.
- Each loan has been underwritten according to the originator's lending criteria, as outlined in the offering circular. This includes proper investigation and search of the relevant properties.
- Loans must be secured on residential property, which is considered to be suitable security based on a valuation by PPF's valuer or a valuer appointed to act on PPF's behalf, or an assessed value by reference to the Nationwide House

Prices Index or any other such indexation basis that might be used by a prudent lender of secured loan products.

- Each loan governed by the Consumer Credit Act 1974 meets the requirements of the Act.
- The maximum aggregate principal amount of arrears mortgages that may be purchased as at the date of purchase is GBP15m.
- All of the mortgages were, or will have been, originated by PPF. All loans have received their first payment instalment.
- The issuer will have the benefit of warranties from PFPLC (the mortgage administrator) in relation to the mortgages, including warranties relating to the lending criteria applied in advancing the loans.

PFPLC will also agree that if any term of any mortgage is found by a competent court to be unfair for the purposes of the Unfair Terms in Consumer Contracts Regulations 1994 or 1999, it shall purchase or procure the purchase of the Mortgage concerned.

■ Origination and Servicing

Fitch visited the site of Paragon's origination and servicing facility and met with senior staff to perform a review of the underwriting and origination process. All servicing is carried out by PPF with GHMLMSL as back-up servicer. Neither company is a Fitch-rated servicer.

Origination

PPF is a wholly owned subsidiary of the Paragon Group of Companies, a group specialising in the provision of financial products to consumers. PPF was established in 1999 and specialises in the origination of secured personal loans and auto loans, both focusing on prime borrowers. PPF is currently originating around GBP30m of loans a month.

The team manager has over 25 years' experience of second-charge lending. Forty underwriters, with an average of eight years of industry experience, are responsible for approving or rejecting business.

The usual purpose of the loans is for consolidation. PPF offers a varied set of products, with terms ranging between three and 25 years, and LTVs up to 125% of the valuation (160% including fees and insurance premia). At present, 26% of the portfolio has an LTV greater than 100%.

The focus on prime borrowers limits the amount of adverse credit allowed. All county court judgements (“CCJs”) greater than GBP1,500 must have been satisfied in full unless they are more than three years old. CCJs of less than GBP250 are ignored for underwriting purposes and may be unsatisfied.

PPF sources all its business exclusively from brokers or packagers. It aims to develop strong relationships with its introducers and uses an internet application system that enables them to apply for loans quickly. The system automatically filters the applications based on a “rules engine” and only offers products that fit the published criteria.

The system also allows PPF and introducers real-time access so that queries can be discussed between underwriters with the data at their fingertips. There is direct contact between underwriters and introducers, and the underwriters are encouraged to develop business relationships with individual brokers. Fitch highlights that this approach can lead to pressure on the individual underwriters to approve cases where they might otherwise have reservations. Strong management controls and checks are in place, however, and act as a mitigant to ensure consistency and compliance with PPF’s guidelines.

In the first instance, PPF tends to use indexed valuations rather than instructing a new physical valuation. In such cases, PPF bases its valuation figures on the CML index and applies 100% of any increase over the values determined by a physical valuation for remortgages from the last five years or purchases from the last 10 years. While it is noted that “real” house prices have risen faster than the index, this approach carries an increased risk. This is mitigated by the fact that 70%-80% of applicants request a physical valuation, and any full inspection is always undertaken by a FISA-approved valuer.

Servicing

PFPLC is the named servicer, performing both primary and special functions. It has invested in sophisticated collections technology following the Group’s adverse credit experience in the early 1990s. In a self-contained site at the Group’s West Midlands base, ongoing contact with borrowers is maintained via a telephone-based debt management system.

Although there is no formal timeframe in which PPF writes off loans, it has an aggressive recovery/follow-up process, which is often determined on a case-by-case basis. So far, only a small number of loans have become seriously delinquent and have proceeded to foreclosure. This could, in part, be due to the “prime” nature of the borrowers at origination, plus the ability to refinance

to a specialised non-conforming secured loan provider in the event of financial difficulty. However, figures suggest only about 5% of borrowers who refinanced were in arrears before doing so.

If, during the arrears workout period, it becomes evident that there is insufficient equity in the property to repay the secured loan, PFPLC may not seek possession. In this case, the approach to arrears is switched to mirror that of a typical unsecured lender, involving a strategy of seeking negotiated pay-offs, attachment of earnings orders or other avenues. Any increase in the value of the property in the future may also lead to payment of arrears.

The transaction legal opinions will confirm that as a second charge holder, Paragon has as much right to foreclose on the loan and repossess the property as the first charge holder. Also, once a loan is foreclosed by Paragon, as the party instigating the proceedings, it will control the repossession and sale of the property. This mitigates the risk of a first charge holder controlling the process and accepting a lower recovery on a property as long as it covers its own loan balance, accrued interest and fees.

Standby Servicing

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

This transaction features a standby servicer, GHLMSL, a subsidiary of Countrywide Credit Industries, Inc., and the largest third-party servicer in the UK, with over GBP60 billion of loans in administration. GHLMSL is contractually required to assume servicing responsibilities in the event that Paragon is no longer able to continue servicing the portfolio.

■ Performance Analytics

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance surveillance team ensures that the assigned ratings remain, in the agency’s view, an appropriate reflection of the issued notes’ credit risk.

Details of the transaction’s performance are available to subscribers at www.fitchresearch.com. Further information on this service is accessible at www.fitchratings.com.

Please call the Fitch analysts mentioned on the first page of this report for any queries regarding the initial analysis or the ongoing surveillance.

■ Appendix 1: Rating Methodology

Model Approach

To determine loss coverage for RMBS, Fitch's default model employs a loan-by-loan review, examining several loan-, borrower-, lender- and property-specific factors that most influence default probability and loss severity. Fitch's base default probability analysis focuses primarily on the borrower's income multiple, in conjunction with the loan's LTV. These expected default rates are then adjusted further by loan, borrower, lender and property attributes. A large component of Fitch's loss severity analysis is market value trends. Fitch's market value assumptions focus on historical regional volatility and sustainable growth. Market value projections are then adjusted by loan and property attributes.

Default Probability Adjustments

Underwriting and Servicing Quality: When applying the default probability matrix, Fitch also considers a lender's underwriting and servicing guidelines. Fitch's views will be formed following a due diligence visit, where the lender's criteria and procedures regarding borrower income, LTV, borrower's past credit performance and many other factors will be considered. Fitch's review and analysis of the originator determines whether it decreases base default rates by up to 25% or increases them by up to 250%.

Investment Properties: Fitch's methodology in evaluating the default probability of a Buy-to-let (BTL) portfolio is to use the UK residential default model, but with the following additional assumptions:

- For the base probability of default, BTL loans are assigned an affordability class based on underwriting criteria related to the minimum interest cover requirement. Generally speaking, Fitch will assign a high affordability class (meaning less affordable and thus a higher base probability of default) unless rental yields are estimated to exceed 150% of the mortgage payment, including principal, and are tested at a stressed interest rate.
- A loan-by-loan increase in base default probabilities by 25% for the fact that the properties are non-owner occupied.
- Increase in the underwriting quality factor to account for lack of experience in BTL. This factor also incorporates originator-specific issues related to underwriting criteria, historical experience as well as servicing capabilities.

Repayment Types: The most common repayment types in the UK market are repayment and interest-only mortgages. Interest-only mortgages are usually linked to some form of investment vehicle: either an endowment policy, a pension or Individual Savings Account (ISA) which are designed to repay the loan principal on maturity. The following factors should be noted:

- Repayment mortgages incur no default probability adjustment.
- Interest-only mortgages are susceptible to the payment shock associated with a 'balloon' repayment for the entire principal at maturity. The borrower may be able to remortgage and thereby pay off his existing mortgage; however if his circumstances have changed this may not be possible. The further off the maturity date is, the more there is capacity for the borrower's circumstances to change. For this reason, Fitch applies an increased default factor to interest only loans of between 1-1.33 depending upon the length of time to maturity.

Loan Purpose: Fitch does not penalise mortgage loans advanced to purchase a home or those advanced to refinance existing mortgage loans, nor loans to release equity for the purpose of home improvements. However, Fitch views mortgage loans advanced to release equity in the home (equity refinance mortgages) in order to consolidate other existing debts (such as credit cards) as more risky by their nature. For this reason, Fitch applies an increased default factor of 1.1-1.25 depending on underwriting criteria for such loans.

Mortgages in Arrears: When rating a portfolio combining current and arrears mortgages, Fitch increases base default rates for mortgages in arrears up to 90 days by factors between 1.25 and 1.75. For mortgages that are in arrears for more than 90 days, Fitch assumes a 100% default probability.

Second Homes: While information about mortgage performance for second homes is limited, Fitch believes that second homes are considerably more susceptible to default. A financially distressed borrower is more likely to default on a second home than on his primary residence. Accordingly, Fitch increases base default by a factor of 1.1-1.25.

Right to Buy: Council tenants have the opportunity to purchase their own homes through the UK government's Right to Buy scheme. Available information suggests that there is a higher propensity to default. For this reason Fitch applies and increases default probability factor of between 1.1-1.25.

Product Type: Most UK RMBS issues are primarily backed by variable rate mortgages. While variable-rate mortgages can experience payment shock due to underlying index volatility, this risk is usually gradual with ½-1% interest rate rises. Other mortgage types commonly available include initially fixed-rate mortgages and capped-rate mortgages which reset to variable rate after a limited period. Although these loans may be more susceptible to payment shocks after the reset date (if rates have risen substantially during the fixed- or capped- rate period) Fitch believes this does not warrant a supplementary default factor. Other product types will be evaluated individually.

Loss Severity

Fitch's UK default model quantifies loss severity (or, conversely, recovery value) by focusing on several factors, including market value declines, foreclosure and carrying costs, and LTV.

Market Value Declines: Fitch's MVD methodology focuses on three key factors: volatility of observed prices from the long-term trend; historical levels of stress experienced in the housing market of each region; and the current position of the index relative to the long-term trend.

For example, the MVDs for East Anglia, London and the South East are highest, reflecting high historical volatility and current prices well above the long-term trend line. The MVD for Scotland is lowest, reflecting low historical volatility and current prices slightly below the long-term trend line.

Indexing of Property Valuation: Fitch's model uses a conservative index to adjust original property values depending on the year of valuation. The index is based on information obtained from sources in the mortgage industry and considers both the year of valuation and the region in which the property is located. Where there has been capital appreciation this is a mitigating factor in the calculation of loss severity but will be offset by higher MVDs assigned to regions that have seen above average price appreciation.

High- and Low-Value Properties: Homes with relatively high or relatively low market values are generally subject to higher MVDs in a deteriorating market than homes with average market values due to limited demand for such properties. Imprecise pricing information, caused by the lack of comparable benchmark homes in the case of high-value properties, also influences the amount of price volatility during a market downturn. The market value thresholds are increased periodically to reflect the increase in housing prices. Adjustments for high- and low-value properties are split between London and the rest of the country due to higher prices in London, and the differential between what would constitute a high- or low-value property.

Mortgage Indemnity Guarantee (MIG) Policies: Many lenders require borrowers to pay for MIG for that portion of their mortgage loan which exceeds a certain LTV level (usually 75%). In case of default by the borrower, the lender will be able to recover any loss on the portion of the loan in excess of that LTV limit (subject to any policy deductions) from the MIG provider. Fitch will give credit for MIG on a case-by-case basis. Fitch will review the MIG policies to determine the extent of coverage and payment terms and to determine whether there are any exclusion clauses which might lead to non-payment of claims by the insurer. The insurer's rating is also taken into consideration when determining the amount of credit to be given for MIG.

Geographic Concentration: Fitch also assumes that a mortgage portfolio is generally broadly diversified in geographical terms. A particular region might be more sensitive to economic downturns and/or other negative developments in the property and mortgages market than others. If a portfolio has significant regional concentrations, Fitch will make adjustments on a case-by-case basis. As a general rule, for pools with high concentrations in specific regions, credit enhancement necessary for a particular rating level will be higher than for geographically diversified portfolios.

Foreclosure and Carrying Costs: When calculating recovery value, Fitch's model reduces the property valuation by foreclosure costs and the cost to the administrator of "carrying" the loan from delinquency through to default. Fitch assumes foreclosure costs amount to 5% of the sale price at the time of foreclosure. This estimate is based on actual cost data supplied to Fitch, and may be adjusted as cost structures change in the industry and jurisdiction.

To calculate carrying costs, Fitch assumes the borrower does not pay interest for 18 months in the case of a residential property and 12 month in the case of an investment property. The interest rate used reflects the need to continue to service the notes during the period that the defaulted loans are not generating any revenue. The 18- and 12- month time frames are based on worst-case estimates obtained from U.K. mortgage lenders.

■ Paragon Secured Finance (No. 1) PLC

RMBS/UK

Capital Structure

Class	Rating	Size (%)	Size (GBPm)	CE (%)	Spread	PMT Freq	Maturity	Coupon	ISIN
A1	AAA	77.0%	231	27.50	[●]bps	Qtrly	2035	[●]	[●]
B	A	14.0%	42	13.50	[●]bps	Qtrly	2035	[●]	[●]
C	B	9.0%	27	4.50	[●]bps	Qtrly	2035	[●]	[●]

	Size (%)	Size (GBPm)
Initial Cash Reserve	4.50	13.50
Target Cash Reserve Post Arrears	5.30	15.9

Step Up Date: November 2009

Key Information

Closing Date	[] December 2004	Parties	
Country of Assets	United Kingdom	Seller/Originator	Paragon Personal Finance Limited
Issuance Date	[●]	Servicer	Paragon Finance PLC
Structure	Pass Through	Lead Manager	Barclays Capital
Bloomberg	PSF1	Standby Mortgage Administrator	GHL Mortgage Services Limited
Settlement	Clearstream & Euroclear	Trustee	Citicorp Trustee Company Limited
Listing	London Stock Exchange	Account Bank	National Westminster Bank
Analyst	Suzanne Albers suzanne.albers@fitchratings.com +44 20 7417 6325		

Others (Summary)

Short Term Rating Triggers (Minimum)	
Account Bank	F1

Structure

Separate revenue and principal waterfalls to repay principal and interest on the notes

The reserve fund is fully funded at closing but will increase to 5.3% upon certain events.

Four-year revolving period; 100% provisioning for loans more than 12 months in arrears; TIM at 4.5%; 25% pre-funding & no collateralisation of negative carry

Credit Committee Highlights

First Paragon transaction composed almost entirely of second-charge mortgage loans used for debt consolidation and other purposes

Higher loss severity due to second-charge nature

WAOLTV 89%, 52% with OLV over 90%, 28% with OLV over 100%

Historical arrears very low, but due to high prepayments; performance through life of loan not seen.

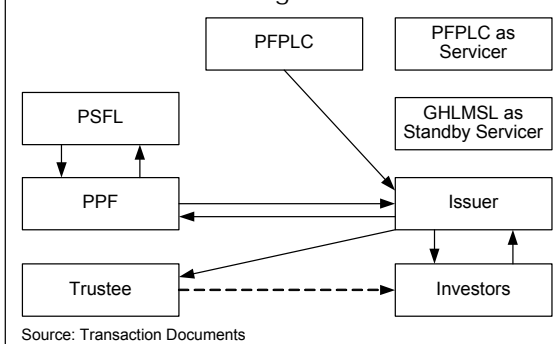
Low concentration in London/Outer Metro/South East at 29.5%

No credit for TIM at 'AAA' level

Fitch Default Model Output

Rating Level	AAA	AA	A	BBB
WAFB (%)	35.00	28.24	21.47	14.70
WARR (%)	11.31	15.36	20.43	26.76
WALS (%)	94.88	92.46	88.98	84.31
MVD	42.33	38.1	33.87	29.67

Basic Structure Diagram



Collateral

Pool Characteristics

Current Principal Balance (GBP)	241,179,698	Regional Concentration (%)³	
Average Current Loan per Borrower (GBP)	22,159	London	7.69
Number of Loans	10,884	Outer Metro	10.50
Seasoning (Months)	11.18	South East	11.32
Loan to Value (LTV) (%)		North West	10.63
WA Combined OLV	88.90	West Midlands	8.84
WA Indexed Combined CLTV ¹	83.97	Second Charge	98.88

Mortgage Characteristics

Borrowers with CCJs (%)	8.64	Owner Occupied	100.00
Valuations based on CML Index (%)	12.50	Purchase	65.24
Less Liquid Properties ²	8.04	Remortgage	34.76
Repayment Loans	100.00		

Interest Rate Type

PPF Variable Rate Loans (%)	98.25	0-39 Days	3.42
Fixed Rate Loans (%)	1.75	31-60 Days	1.18
WA Interest Margin over Libor (%)	4.69	61-90 Days	0.63
		> 90 Days	1.23

¹ Based on 50% credit given to upwards movements in Nationwide regional house price indices. ² Particularly large or small properties at less liquid extremes of market

³ Geographic distribution is calculated using Nationwide regional indices

Source: Fitch, Pool cut of 30 September 2004 provided by Paragon Personal Finance Limited.

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