FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms 3 Paragon Mortgages Transactions

Wed 30 Aug, 2023 - 10:52 AM ET

Fitch Ratings - London - 30 Aug 2023: Fitch Ratings has affirmed Paragon Mortgages (No. 26) PLC, Paragon Mortgages (No. 27) plc and Paragon Mortgages (No. 28) PLC. A full list of rating actions is 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 Affirmed | AAAsf Rating Outlook Stable |
| C XS2132137410 | LT | A+sf Rating Outlook Stable Affirmed | A+sf Rating Outlook Stable |

| | | |
|---|---|---|
| D XS2132137683 | LT BBB+sf Rating Outlook Stable Affirmed | BBB+sf Rating Outlook Stable |
| Paragon Mortgages (No. 26) PLC | | |
| A1 XS1938530646 | LT AAAsf Rating Outlook Stable Affirmed | AAAsf Rating Outlook Stable |
| A2 XS1938530729 | LT AAAsf Rating Outlook Stable Affirmed | AAAsf Rating Outlook Stable |
| B XS1938531024 | LT AAAsf Rating Outlook Stable Affirmed | AAAsf Rating Outlook Stable |
| C XS1938531370 | LT A+sf Rating Outlook Stable Affirmed | A+sf Rating Outlook Stable |

VIEW ADDITIONAL RATING DETAILS

## TRANSACTION SUMMARY

The transactions are the 26th, 27th and 28th in 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

**Stable Asset Performance:** The transactions' arrears have remained lower than similar transactions in the broader UK BTL sector. Paragon 26 had one-month plus arrears of 0.77% (0.57% at the last review) at 30 April 2023. Paragon 27 one-month plus arrears were 0.13% (0% as at the last review) at 30 June 2023 and Paragon 28's were 0.06% (0.11% as at the last review) at 31 May 2023. Paragon's efficient use of rent receivership if arrears level exceed two months, has contributed towards the low level of delinquencies across the series.

Annualised prepayments in Paragon 26 peaked in October 2022 at 51%, as customers rolled off their initial fixed-rate periods. Prepayments have been relatively low in Paragon 27 and Paragon 28, averaging 3.6% and 7.8% over the last 12 months, as the majority of customers have not yet rolled off their fixed-rate periods.

**Interest-only Concentration:** There is a material concentration of interest-only (IO) loans maturing within a three-year period during the lifetime of the transactions. This is 42.8% between 2040-2042 for Paragon 26, 55.4% between 2042-2044 for Paragon 27 and 56.6% between 2043-2045 for Paragon 28. Where a concentration is present, Fitch will derive the IO concentration weighted average foreclosure frequency (WAFF) and apply the higher of the IO concentration WAFF and the standard portfolio WAFF for each rating level in the analysis. For these pools, Fitch has applied the FF based on the IO concentration WAFF.

**Desktop Valuation Adjustment:** Paragon 28's pool includes 9.6% of properties valued at origination (currently 8.9% of the pool) through a desktop valuation during the 2020 lockdown, when physical valuations were not allowed. A desktop valuation process, which was restricted to a limited number of non-complex properties with up to four tenants sharing, was conducted by Paragon's in-house team of regional surveyors. Fitch notes that a rigorous process was in place and that desktop valuations only applied to a minority of the total originations, representing a limited number of cases. Consequently, Fitch has not applied any adjustment to the desktop valuations in this pool.

**Product Switches:** Switches in repayment types are limited. Before the step-up date, there are few and generic limitations on the potential changes to loan interest rates upon switch. Fitch has therefore modelled extensive use of interest rate conversions to stress any excess spread in the asset portfolio and hedging interest rate mismatches.

**Rating Higher than MIR**: Paragon Mortgage 26's class D notes' rating is three notches above the model-implied rating (MIR). Fitch expects the notes' MIR to be 'BBB+sf' in future model updates due to sequential note amortisation, the proximity of the product switch end date (August-2024) and the rating resilience shown by bespoke rating sensitivity analysis (whereby the length of new fixed-rate period upon product switch was shortened, also due to the current interest rate environment).

## RATING SENSITIVITIES

### Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The transactions' performance may be affected by adverse 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 (CE) available to the notes.

Additionally, unanticipated declines in recoveries could result in lower net proceeds, which may make certain notes 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 foreclosure frequencies (FF) and recovery rate (RR) assumptions, and examining the rating implications on all classes of issued notes.

For example, a 15% WAFF increase and 15% WARR decrease would have no rating impact on Paragon 26's notes. The sensitivity would result in a one-notch downgrade of Paragon 27's class B notes, but have no impact on any other notes. For Paragon 28, it would result in a one-notch downgrade of the class B and C notes, with no impact on any other notes.

### 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 and, potentially, upgrades. A decrease in the WAFF of 15% and an increase in the WARR of 15% would not result in an upgrade of any Paragon 26 notes. The sensitivity would result in a three-notch upgrade of Paragon 27's class D notes, with no impact on all other notes. For Paragon 28, this would result in an upgrade of up to one notch and three notches for the class B and D notes, respectively, but have no impact on any other notes.

### 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 pool and the transaction. 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.

Prior to the transactions closing, Fitch conducted a review of a small targeted sample of the originator's origination files and found the information contained in the reviewed files to be adequately consistent with the originator's policies and practices and the other information provided to the agency about the asset portfolio.

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 entity. 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 Counterparty Rating Criteria: Derivative Addendum (pub. 01 Aug 2022)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 28 Dec 2022)

UK RMBS Rating Criteria (pub. 17 Feb 2023) (including rating assumption sensitivity)

Global Structured Finance Rating Criteria (pub. 01 Mar 2023) (including rating assumption sensitivity)

Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 14 Mar 2023)

Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 07 Jul 2023)

## APPLICABLE MODELS

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

Multi-Asset Cash Flow Model, v2.13.1 (1)

ResiGlobal Model: UK, v1.4.1 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| Paragon Mortgages (No. 26) PLC | UK Issued, EU Endorsed |
| Paragon Mortgages (No. 27) plc | UK Issued, EU Endorsed |
| Paragon Mortgages (No. 28) PLC | UK Issued, EU Endorsed |

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