RMBS/UK
Presale Report

Paragon Mortgages (No. 12) PLC

Expected Ratings*

Class	Amount (GBPm Equiv)	Final Maturity	Rating	C/E (%)
A1 and A2	1298.25	2038	AAA/F1+	15.35
B	111.75	2038	AA	7.90
C	90.00	2038	A	1.90

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* Expected ratings do not reflect final ratings and are based on provisional pool and information provided by the issuer as of 26 June 2006.

■ Summary

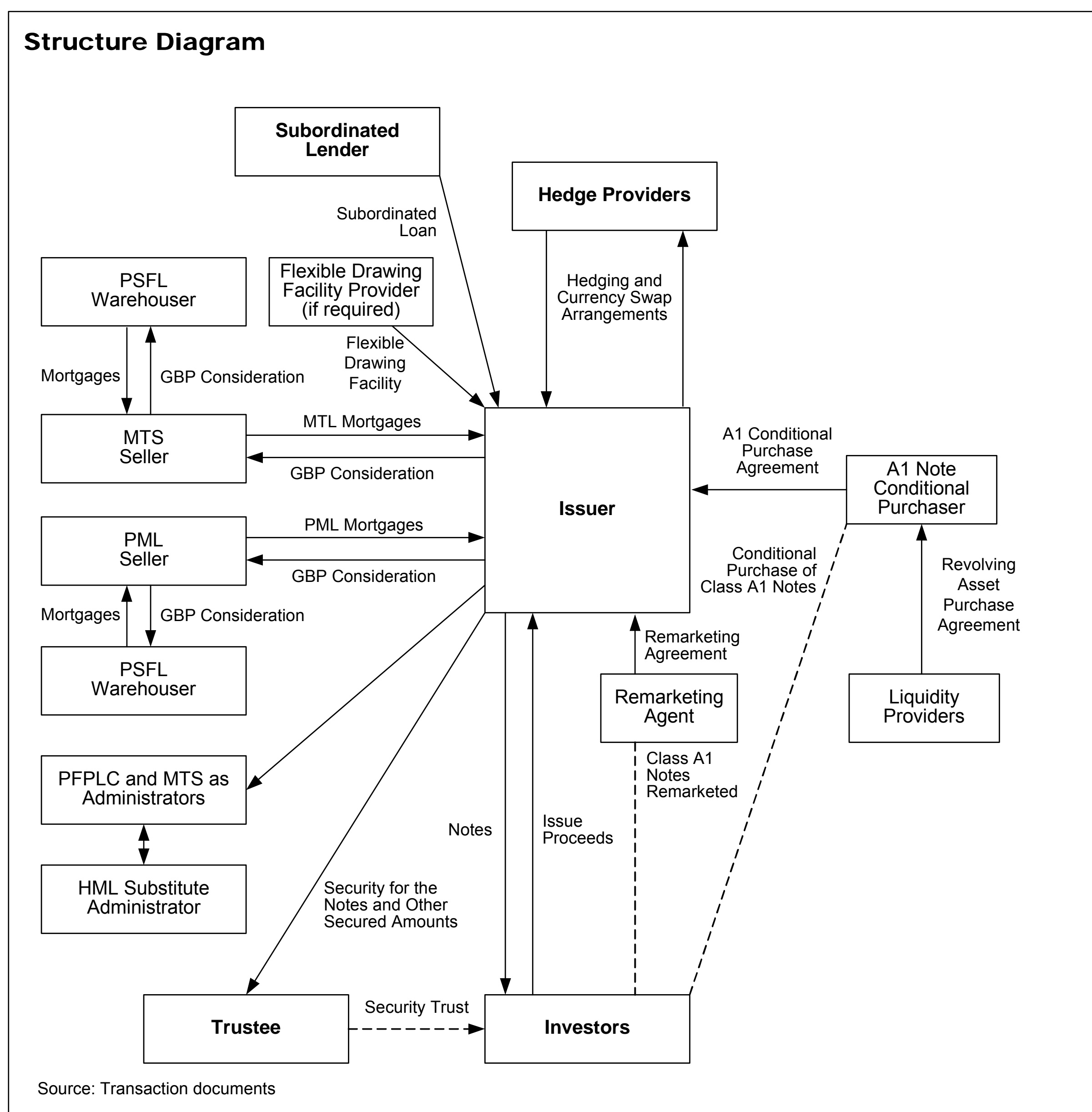
This GBP1,500 million-equivalent transaction is a securitisation of residential mortgages originated in the UK. Fitch Ratings has assigned expected ratings to the notes to be issued by Paragon Mortgages (No. 12) PLC ("the issuer" or "PM12") as indicated at left.

The expected ratings are based on the quality of the collateral, available credit enhancement, the underwriting processes of Paragon Mortgages Limited ("PML") and Mortgage Trust Limited ("MTL"), as well as the servicing capabilities of Paragon Finance PLC ("PFPLC") and Mortgage Trust Services PLC ("MTS") in relation to both the PML and MTL mortgages. PFPLC and MTS are both wholly owned subsidiaries of The Paragon Group of Companies PLC ("the group"). The expected ratings are also based on the capabilities of Homeloan Management Ltd ("HML") as stand-by administrator and the sound legal structure of the transaction. Credit enhancement for the class A1 and A2 notes will be provided by the subordination of the class B notes (7.45%) and class C notes (6.00%) and a reserve fund of [1.90%], which will be fully funded at closing. The reserve fund will build up to [2.40%] on the occurrence of certain arrears triggers.

Approximately 60.75% of the loans by value in the provisional mortgage pool have been originated by PML and 39.25% by MTL. In the context of residential mortgage lending, PML specialises in the origination of buy-to-let loans to "professional" landlords, defined as borrowers with at least 12 months' experience managing at least three rental properties. MTL specialises in lending to "private investor" landlords, with between one and five properties in their portfolio. All of the loans in the reference portfolio are secured on investment properties belonging to such borrowers.

The group offers an array of financial products, ranging from personal, retail point-of-sale and auto loans to prime residential mortgages. This is the group's 12th transaction in the Paragon Mortgages series.

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 the additional risks associated with buy-to-let lending (see research "*UK Residential Mortgage Default Model III*" of 26 July 2005, available on *www.fitchratings.com)*. Fitch also modelled the cash flow contribution from excess spread using its European RMBS cash flow model (see research "*A Guide to Cash Flow Analysis for RMBS in Europe*" of 20 December 2002 available on 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 details on Fitch's rating approach to, and performance of, the RMBS market and all are available on www.fitchratings.com:

- "*European Mortgage RMBS, Housing & Credit Newsletter*" (dated 8 June 2006);
- "*Origination and Servicing Standards in the UK Residential Mortgage Market*" (dated 12 July 2005);
- "*Rising Stars? Fitch Issuer Report Grades H1 2005 Update*" (dated 7 June 2005);
- "*Rent Review 2004 – An Update on the UK Buy-To-Let Market*" (dated 20 January 2004);
- "*The Weakening Outlook and Growing Political Risks Facing UK Housebuilders*" (dated 22 November 2004);
- "*UK Residential Mortgage Default Model III*" (dated 26 July 2005);
- "*A Guide to Cash Flow Analysis for RMBS in Europe*" (dated 20 December 2002);
- "*UK Non-Conforming RMBS: Performance Reviewed Q205*" (dated 13 January 2006);
- "Pound Stretchers? Self-Certification Mortgage Products in the UK" (dated 19 December 2003);
- "*Calculation Errors in European Structured Finance*", dated 18 April 2006

Credit Committee Highlights

Cash Flow Analysis

- The class A1 notes are intended to constitute eligible securities for purchase by money market funds, and will be remarketed by the remarketing agent annually, beginning on the 15 May 2007 interest payment date. If the remarketing agent (Barclays Bank PLC, rated 'AA+/F1+') is unable to identify sufficient third-party purchasers for all the outstanding A1 notes at or below the margin of the A2 notes, it will, as agent for the trustee and the issuer, require Sheffield Receivables Corporation ("Sheffield"), as the conditional note purchaser, to acquire the outstanding A1 notes. Barclays Bank PLC is the liquidity provider to Sheffield and hence the 'F1+' expected rating assigned to the notes is therefore dependent on the creditworthiness of the liquidity facility provider to the conditional note purchasers. Given the legal final maturity of 2038, the class A1 notes will also have a 'AAA' expected rating.

- The administrators have adopted a threshold interest margin mechanism in this transaction designed to ensure that the weighted average ("WA") contractual margin over three-month LIBOR (including income or expenses from any hedging (if put in place pre- or post-closing), investments and redemptions) on the reference portfolio is at least 1.6% and will step-up to 2.0% in August 2011. Should the WA 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 or make a drawing on the subordinated loan (see *Reserve Fund* below) such that the required levels are met. Fitch has stressed the threshold interest margin rate that is achieved in its 'AAA' and 'AA' analysis, which has reduced the excess spread available to the transaction in such scenarios.

- Some 12.73% of the provisional pool by value consists of loans with "teaser" rates (discounted loans) that are below the stabilised rates to which they will revert at the end of the introductory period. No cash collateral has been posted to make up the differential between the stabilised rate and the current rate. Accordingly, the extent of available excess spread during any remaining teaser rate period is restricted. Fitch has modelled the expected run-off of the teaser rates in its cash flow analysis.

- The majority of the discounted loans pay rates at a margin over three-month LIBOR (as do the majority of the non-discounted variable loans that make up 17.57% of the loans) and all loans with an initial fixed rate (69.71%) will revert to such a rate. Although the notes also pay a margin over three-month LIBOR, the three-month LIBOR basis for the notes will reset on 15 February, May, August and November, whereas the three-month LIBOR basis for the assets will reset on the first day of January, April, July, and October for the PML loans, and 1st December, March, June and September for the MTL loans. The transaction does not incorporate a swap to hedge this mismatch between the rate reset dates, and Fitch has factored this into its cash flow analysis.

- The reserve fund will not amortise. The initial and target reserve fund will be [1.90%] of the outstanding note balance. The reserve fund will step up to [2.40%] if 60+ day delinquencies exceed 3% of the then-current balance of the loans.

- PM12 benefits from a liquidity ledger within the first loss fund. Upon a trigger breach, where 7.5% of the portfolio is more than three months in arrears, a liquidity ledger will be established in the first loss fund. At that time it will equate to 1.6% of the then-current outstanding balance of the notes through trapping available excess spread or, if this is not available, by trapping principal through the available redemption funds. The first loss fund will be available to cover credit losses (on the principal deficiency ledger, "PDL") and will be maintained at least at a floor of 1% of the principal balance of the notes at closing. The amount by which the balance of the first loss fund exceeds the liquidity amount (1.6% of the then-current note balance) will be available to pay interest and senior expenses of the issuer and to make up any principal losses on the PDL should there be insufficient spread on the assets to meet these obligations. Once this amount has been fully drawn, the liquidity reserve can only be used to cover interest/swap currency interest on the notes, subject to the following conditions:

  a. The liquidity reserve can only be used to cover class B interest if the sum of payments to cover class A and B interest and the outstanding PDL does not exceed the outstanding balance on the class B and C notes.

b. The liquidity reserve can only be used to cover class C interest if the sum of payments to cover class A, B and C interest and the outstanding PDL does not exceed the outstanding balance on the class C notes.

Asset Analysis

- Please see Appendix 1 for a comparison between the level of 90+ day arrears and cumulative losses for the earlier Paragon Mortgage ("PRS") and First Flexible transactions issued by MTL and PML. Further information can be found in Fitch's "*UK Non-conforming RMBS: Performance Reviewed Q205*" report, available on www.fitchratings.com.

- Fitch's analysis of the provisional pool data dated 28 April 2006 is based on maximum drawable balance for flexible loans and hence the figures will differ marginally from those in the offering circular.

- The percentage of loans more than three months in arrears has remained consistently low in all PML and MTL transactions. MTL arrears have been slightly higher than PML arrears due to the characteristics of the borrowers in the earlier First Flexible portfolios, reflective of the target market and the inclusion of residential mortgages in some of the earlier First Flexible deals. In H104 servicing of MTL's First Flexible portfolios moved to Solihull from Epsom which, as expected, caused a temporary increase in arrears. First Flexible 4 is the only First Flexible transaction to have suffered any loss at all. However, the losses account for less than 1 basis point of the original portfolio balance.

- The portfolio consists entirely of buy-to-let loans. Fitch considers loans on buy-to-let properties to be inherently more susceptible to default than those secured on an owner-occupied property, simply because the borrower is more likely to default on a loan secured on an investment property than on one secured on their own home. The base default probability for these loans is therefore increased within Fitch's default analysis. For additional information about Fitch's view on this market in the UK please see "*Rent Review 2004 – An Update on the UK Buy-to-Let Market*" dated 20 January 2004 and available at www.fitchratings.com. However, in mitigation, most of the PML borrowers are considered professional landlords, with a proven history of maintaining a portfolio of investment properties. Around 75% of the MTL borrowers are viewed as private investor landlords making a long-term investment in the property market.

- There is a degree of "granularity" in the pool owing to clusters of properties in certain districts favoured by professional and private investor landlords.

- It is possible that a single professional borrower could accumulate a substantial number of mortgage loans from PML, each backed by a property and a corresponding stream of rental income, while in MTL the private investor borrower usually has between two and five properties. While this represents a potentially increased exposure to a single obligor, the normal evolution of an investment portfolio over time means that all its constituent loans are unlikely to find themselves in a single securitisation issue. Fitch has assessed the *pro rata* amortisation conditions and the size of the reserve fund in light of the risk of exposures to individual borrowers.

- As a result of its preference to work with professional landlords, PML focuses on the credit profile of a borrower and their demonstrated ability to manage a portfolio of properties. The underwriting methodology therefore begins with a full assessment of the borrower's underlying credit position before a decision to lend, or not, is made, rather than relying solely on a rent-to-interest coverage ratio. Only when PML is comfortable with the borrower's credit profile is an assessment of each property made, based on a combination of LTV (loan-to-value) analysis (maximum 85%) and rental interest coverage ratio ("ICR", generally a minimum of 120%, but 100% in limited circumstances). For all originations, PML's minimum ICR for a loan was calculated using the PML reference rate, which was 5% at the time of writing. The PML reference rate is reviewed regularly, taking into account movements in base rates and LIBOR. It may sometimes be below those rates charged on the loans, and the ICR, when calculated using the actual loan rate, and may result in a ratio below 120% or 100%. The ICR calculation is only one element of PML's underwriting process, with a thorough understanding of each borrower's financial position and, for professional landlords, experience as a landlord being of equal, if not greater, importance.

- The WA ICR, based on the stabilised margin over current LIBOR is 127%. The PML/MTL ICR threshold of 120%, with exceptions in

certain cases of down to 100% for professional landlords, is more conservative than the 100%-110% minimum ICRs that some other non-conforming lenders are offering.

- Fitch continues to stress the portfolio's default rates beyond those for a prime owner-occupier portfolio at all rating levels, despite having lower arrears than comparable prime portfolios. This stress addresses the relative youth of and the lack of historical track record through a recession in the UK buy-to-let sector.

- 4.86% of the portfolio comprises flexible loans, all of which were originated by MTL. This product affords borrowers the ability to prepay a portion of their principal balance at any point (monthly, annually, etc) and use the prepaid amount as a line of credit that they can redraw at any point in the future. Some borrowers with interest-only loans may draw on a line of credit limit greater than their original drawdown. In addition, borrowers may take "payment holidays" by applying prepaid amounts in lieu of scheduled repayments. The general limitations, however, include that if the borrower prepays more than 20% (the "threshold amount") of the scheduled principal balance, a "commitment fee" of 1% per annum will be charged on amounts in excess of the threshold. The borrower may reschedule their loan to avoid such penalties, but the redraw would then not be available. In most cases, and for all newly originated loans, MTL retains the right to change the commitment fee at any time.

  In line with PM11, no redraw facility will be in place to fund the redraw amounts of flexible loans. Fitch adjusted the available excess spread to account for the additional liquidity requirements associated with this type of mortgage.

- Borrowers of flexible mortgages are entitled to take advantage of their flexible features, including redrawing and payment holidays, to the extent they have prepaid. Fitch believes that if borrowers experience financial distress, some may redraw and postpone payments prior to eventual default, and has adjusted its loss severity assumptions accordingly.

- Less liquid properties comprise 11.67% of the portfolio. A proportion of these properties are large dwellings broken down into individual apartments, mitigating this risk.

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 will be protected firstly by any excess spread, secondly by the reserve fund [1.90%] and thirdly by the subordination of the class B and class C junior tranches (13.45%). The class B tranche will be supported firstly by any excess spread and secondly by the reserve fund and thirdly by the class C tranche (6.00%). Whereas the class C tranche will be supported by available excess spread and the reserve fund.

The reserve fund will also be available to cover interest shortfalls and losses, subject to certain restrictions on paying interest on the junior notes (see *Reserve Fund* below). The reserve fund will build to 2.40% in the event a certain level of arrears is exceeded.

Available residual excess spread is 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 PM12 are split into revenue and principal and are, subject to certain exceptions (see *Principal Used for Senior Interest Liquidity* below), paid via separate waterfalls. All revenue received on the issue (e.g. borrower interest payments, swap payments and interest earned on cash in the transaction account prior to the interest payment date) will be applied on each payment date in the following priority of payments:

1. Trustee and substitute servicing fees.
2. Senior Servicer fees.
3. *Pro rata*, amounts due and payable: (i) under the basis and class A1, A2 currency swap agreements; and (ii) as interest to class A2 noteholders.
4. Should a debit balance recorded on the PDL exceed the balance of the then-outstanding class B and C notes, an amount applied in extinguishing that excess.
5. *Pro rata*, amounts due and payable: (i) under the class B currency swap agreements (see *Interest Risk and Basis Risk* below); and (ii) as interest to the class B noteholders.
6. Should the debit balance recorded on the PDL exceed the balance of the then-outstanding class C notes, an amount applied in extinguishing that excess.
7. *Pro rata*, amounts due and payable: (i) under the class C currency swap agreements; and (ii) as interest to the class C noteholders.
8. VAT to be paid, if any.

9. Amounts applied in extinguishing a debit balance on the PDL.
10. Amounts required to replenish the reserve fund.
11. Other subordinated amounts, including a provision for a reserve to fund any purchase of caps, other hedging instruments in the next period, the subordinated servicer fee and deferred purchase consideration.

Items (4) and (6) above ensure that, should the debit balance recorded on the PDL exceed the balance of the then-outstanding subordinate notes, any PDL debit balance corresponding to the class A or B notes, respectively, will be reduced to zero prior to the payment of interest on any notes subordinate to each respective class.

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 available 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

All the class A notes, irrespective of class, will rank *pari passu* and rateably in their right to receive both principal and interest without any preference or priority among themselves.

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

- the balance of junior notes as a proportion of the total outstanding balance of notes exceeds double that at closing;
- there is no debit balance on the PDL;
- the balance of loans over three months in arrears is less than 7.5% of the then-current balance;
- the total outstanding balance of the class B & class C notes is greater than [4.76%] of total balance of notes issued at closing.

Optional

At the option of the issuer, it is possible to redeem all of the notes plus accrued interest in the following circumstances:

- on or after the interest payment date in August 2010;
- once the then-current outstanding principal amount is less than 20% that at closing; or
- if the issuer or any hedge provider is required to make any withholding tax deductions.

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

Final

To the extent not previously paid down, the notes are due to be redeemed in full in November 2038.

Interest Rate and Basis Risk

Some 69.71% of loans in the provisional pool have a fixed rate of interest for a specified period lasting until, at the latest, July 2012. There is also the possibility of variable rate loans being subsequently converted into fixed-rate loans after closing, therefore the proportion of fixed-rate loans in the portfolio may be extended beyond that implied by the fixed-to-floating reversion schedule.

To hedge its exposure to fixed and any converted capped-rate loans in a rising LIBOR environment, the issuer will enter into master interest rate exchange agreements with JPMorgan Chase Bank, N.V. (rated 'A+/F1+') and ABN AMRO Bank NV (rated 'AA-/F1+'). Any increase in this exposure will be accompanied by a suitable extension of the hedging arrangements, funded from excess spread trapped in a subordinated position in the revenue priority of payments on the previous payment date.

Around 7.15% of the portfolio is charged against PML's or MTL's standard variable rate ("SVR"), which itself can be based on three-month LIBOR or the Bank of England Base Rate. The potential mismatch between three-month LIBOR to be paid on the notes and the SVR-based rates to be paid on the underlying loans will not be specifically hedged within the transaction. Also, the potential mismatch between the three-month LIBOR basis for the notes and the underlying PML and MTL loans based on when their reset dates occur each quarter is similarly not specifically hedged. Rather, PML has a threshold interest margin mechanism in this transaction designed to ensure that the weighted average contractual margin over three-month LIBOR on the reference portfolio as a whole will be at least 1.6%, rising to 2.0% after August 2011. Should the weighted average margin fall below these levels, the mortgage administrator will, under the mechanism, be obliged to increase the SVR on the pool or ensure that there are sufficient funds in the shortfall fund to maintain the minimum level. Fitch has stressed the

threshold interest margin rate that is achieved in its 'AAA' and 'AA' analysis.

Fitch has also stressed the potential mismatch between tracker, SVR and LIBOR-linked loans with different reset dates than the three-month LIBOR paid on the notes, which has reduced the excess spread available to the transaction in such scenarios.

Currency Risk

The issuer will enter into currency swaps to hedge the currency mismatches between the GBP-denominated assets and the USD and EUR note liabilities of some of the note classes.

Swap Counterparty Rating Requirements

The basis swap counterparty must be rated 'F1/A' and the currency counterparty 'F1/A+'. In the event of a downgrade of a counterparty below either of these levels, under the terms of the transaction, that 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+', that counterparty will 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 be replaced by or guaranteed by a suitably-rated counterparty.

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

Pre-Funding

There is no pre-funding expected in this transaction.

Non-Verified Loans

At closing, all of the loans will have made their first payment.

Credit Enhancement and Liquidity

Reserve Fund

The [GBP 28.5]m reserve fund (1.90% of the issue) will be fully funded on day one via a subordinated loan advanced by PFPLC and MTS. The reserve fund will further increase to 2.40% in the event that arrears in excess of 60 days exceed 3% of the portfolio.

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

Fitch has not given credit for the subordinated loan drawings as the provider is not rated by the agency.

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, 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 tenures), then there is 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 flows in RMBS transactions is further discussed in Appendix 1 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

The figures provided in Fitch's collateral analysis are based on the maximum drawable balance for the flexible mortgages and consequently differ slightly from those in the Offering Circular.

The entire provisional pool analysed consisted of prime residential buy-to-let mortgage loans with a total outstanding balance of approximately GBP683m (as at 28 April 2006). 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.

Buy-to-Let

100% of the loans in the portfolio are buy-to-let. Fitch applies an additional default hit to these to reflect the fact that;

- 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 financial stress; and,

- the servicing of the loan is primarily dependent on rental income, which may be more volatile in stress periods than personal income.

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.

However, Fitch notes that while the minimum required ICR is normally 120% (based on Paragon reference rate), 28.90% of the loan portfolio by value has ICR ratios (based on stabilised margin over LIBOR) above 130% of which 15.27% by value has ICR ratios above 160%. This would suggest that borrowers are protected to some degree from a potential reduction in rents or increases in interest rates.

Fitch notes too that a significant proportion of the borrowers in this portfolio are professional landlords, with a minimum of 12 months' experience of managing at least three properties and with a recognised aptitude for enforcing tenancy contracts. The remaining buy-to-let borrowers are private investor landlords, also with significant experience, who aim to stay in the market for the longer term. This is a mitigant in minimising any downtime between tenancies. Another mitigating feature of buy-to-let loans in general is that, upon default, the foreclosure process is likely to be quicker than in other cases, as tenants with short-hold tenancy agreements can generally be more easily evicted than owner-occupiers, while the property can be repossessed more speedily. For a more detailed commentary, please refer to the *Origination and Servicing* section on page 10.

Repayment Type

Some 93.61% of the pool comprises interest-only mortgages. Fitch applies a default stress to these loans that reflects the increased risk of default at maturity due to the risk that the borrower may be unable to refinance the loan at this time.

Arrears Loans

In the provisional pool, 0.42% of loans by current balance are currently more than 30 days in arrears, of which 0.11% are over 90 days in arrears. Fitch assumes that loans in arrears are more likely to default, and applies more conservative default adjustments to these.

Interest Rate Type

Some 69.71% of loans by current balance are fixed rate for a pre-specified period, after which they revert to variable rate. All the fixed rate loans in the provisional pool will have reverted at the latest by July 2012. While this may lead to a minor payment shock, Fitch does not believe this warrants any special adjustment to default probabilities. The remainder of the loans in the pool have interest rates linked to LIBOR and in a few cases LIBOR via the PML/MTL standard variable rate.

The ratio of fixed to variable rate loans may change not only as a result of rate offers expiring, but also following the approval of borrowers' requests to the administrator to convert their mortgages, see "*Interest Rate and Basis Risk*" above.

Conversion

Subject to certain conditions, the Administrator may approve borrower requests to convert certain aspects of their mortgages, for instance, from a variable rate loan to fixed or capped. In the case of capped-rate mortgages, to approve this change the issuer would have to ensure that it has the necessary cash in order 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 drawing from the subordinated loan from PFPLC and MTS, whose subsequent claim would be in a subordinated position in the revenue waterfall.

Further Advances

Mandatory further advances are made to borrowers who have flexible mortgages and who have overpaid, or to those who have the right to obtain a further advance upon the completion of construction works or refurbishment of their properties. 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, recoveries or the subordinated loan, 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 no greater than 16% of the original note balance;

- the reserve fund is at its required amount;

- in respect of discretionary further advances, the borrower has not been in arrears in the previous three months or in breach of the mortgage conditions;

- the WA current LTV of the portfolio would not exceed its value by more than 1% after utilising the pre-funding; and

- arrears over three months do not exceed 2% of the then-outstanding balance of the pool.

Legal Structure

The PM12 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 PM12 (a public company incorporated under the laws of England and Wales). There will be no recourse to the sellers so that the transfer to PM12 will be treated as a true sale.

At closing, PM12 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 will include first-lien mortgages and first-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 the originator in relation to the pool of mortgages. No search of title will be conducted by the issuer or the trustee; rather they will 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 the following:

- Each mortgage constitutes a first-ranking legal mortgage or a second-charge mortgage when either PML or MTL are holders of the first 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 outlined in the offering circular. This includes proper investigation and search of the relevant properties.

- Prior to granting the loan, a property valuation was conducted by PML's or MTL's in-house valuers or an independent valuer from the panel of valuers appointed by the originators.

- Each loan governed by the Consumer Credit Act 1974 meets the requirements of the Act in full.

- The maximum aggregate principal amount of mortgages in arrears which may be purchased as at the date of purchase is GBP10.0m.

- At its date of completion, each property was insured under a buildings policy or a block buildings policy.

- All loans were originated by PML or MTL.

- All loans have received their first payment instalment.

Origination and Servicing

Paragon Mortgages Limited Origination

PML is a subsidiary of the Paragon Group, which specialises in the provision of various financial products to consumers. As a mortgage company, PML specialises in the origination of buy-to-let products, and since February 2001, the vast majority of originations have been to so-called professional borrowers. To qualify for the benefits of such a loan – notably a higher LTV – a borrower must already possess a portfolio of at least three properties and must present at least 12 months' of financial accounts for the underwriters to scrutinise. Such professional borrowers are typically characterised as individuals who earn a substantial portion of their income from the rental yield on their portfolio; indeed, some may rely entirely on this source of income for their livelihood. For new originations, PML requires that expected rental yields must normally exceed 120% of monthly interest payments based on the PML reference rate.

PML has five levels of underwriting based on a hierarchy of mandates. To increase borrowings above these levels it may request additional information, such as a business plan or performance data or conduct an interview with the applicant. Large exposures, i.e. in excess of GBP1m, to single borrowers are monitored via an annual review of accounts, letting conditions, voids, demand, cash flows, as well as a consideration of the borrower's strategy for the next 12 months. These controls are designed to ensure PML is kept abreast of the performance of key borrowers' portfolios, and may mitigate against single obligor concentration within the reference portfolio.

As with other buy-to-let lenders, PML prefers to retain human discretion in its lending procedures rather than adhere to a *pro forma* approach, and, as such, a hierarchy of mandates adhering to guidelines and criteria ensures that accountability is maintained. At the heart of policy-making is the overarching credit committee – comprising four standing members, department heads and other experts – which convenes on a monthly basis and which presides over any changes to criteria and special cases. Voting by department heads is restricted to departments other than their own, a segregation of duties that helps prevent "relationship-lending" factors influencing credit decisions.

Professional landlords are believed 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. This assertion is based on the time and energy that professional landlords are able to spend administering their portfolio and researching the market.

Mortgage Trust Limited Origination

MTL, part of the Paragon Group since June 2003, launched its new brand in September 2003. MTL specialises in the origination of buy-to-let products, and the majority of originations are to private investor borrowers. These borrowers typically possess a portfolio of between two and five properties and are investing in the property market for the longer term. MTL borrowers are expected to have rental yields generally exceeding 125% of mortgage repayments on an interest-only basis. This ICR calculation is based on either the underlying LIBOR-linked charging rate or the Paragon reference rate.

Mortgages are originated via direct distribution centres and, indirectly, through a network of brokers. The underwriters at MTL have experience either in-house or with high street lenders. New hires follow a specific training/mentoring programme, after which they are gradually given increasing underwriting limits. Although underwriters follow the underwriting guidelines established by MTL, they are allowed certain "discretion points" based on their seniority/experience. This results in an application to completion rate of approximately 65%.

Both PML and MTL originate buy-to-let loans, which will not be qualified as regulated loans under the Financial Services Authority ("FSA"). Nevertheless, MTS may originate a very small number of owner-occupied loans that must qualify for FSA regulation. MTS has been granted authorisation by the FSA for regulated mortgage lending.

Underwriting

PML and MTL each have their own dedicated underwriting teams of approximately 30 full-time equivalent employees. The underwriters are usually recruited from within the business, and all receive "one-on-one on-the-job" training. If the underwriters are new to the business it is expected they will need six months training prior to receiving a lending mandate. Monthly sample checks are completed against all underwriters by line management and further random checks are completed immediately after completion of a loan. Other control mechanisms are in place on the systems to ensure mandates and lending thresholds are not over-ridden. HUNTER has been used as a fraud detection tool since 1995, and both PML and MTL are switching to SIRA (Syndicated Intelligence for Risk Avoidance) during 2006.

Valuations

The Paragon Group of Companies has 17 directly employed "staff" surveyors who complete approximately 70% of valuations; the remaining 30% are completed by "panel" surveyors. It is expected that more unusual properties are surveyed by the staff surveyors. All surveys completed by panel surveyors are audited by a PML staff surveyor.

Servicing

PFPLC is responsible for administering the mortgage loans in the PML-originated portion of the portfolio. It invested in sophisticated collections technology following the adverse credit experience suffered by the Group 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 known as CACS. CACS enables collection agents to schedule calls to borrowers upon a missed payment and provides a detailed diary-based collections management platform. Fitch notes that this site has substantial operational history, and considers PFPLC to be more than adequate in its role as servicer.

MTS (as servicer for the MTL-originated loans) has an experienced mortgage servicing operation. The systems developed are user-friendly and tailored specifically to the needs of securitisation. MTL's origination remains in Epsom while collection is in Solihull. Collections and arrears management are now performed by PFPLC and MTS, using PFPLC/MTS employees, who operate the same systems and processes as for the PML-originated mortgages.

Standby Servicing

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

HML will act as a standby servicer for this transaction. In the event that PFPLC and MTS are no longer able to continue servicing the portfolio, HML will be contractually required to assume servicing responsibilities.

Cash and Bond Administration

The cash bond administration ("CBA") function for this transaction will be carried out by PFPLC. Around nine people within the finance & treasury functions of the organisation are involved in the CBA. The team currently handles CBA for 15 transactions. The function is led by a manager with eleven years' experience of securitisation. He reports into the head of finance who also has significant securitisation experience.

Once a deal is closed, the structured finance team will produce a summary document which includes deal structure, triggers and conditions that the CBA teams needs to be aware of to administer the deal. A training session will also be held to review the transaction details and will, if needed, give particular focus to any features of a transaction that are new or novel.

Cash flows are reviewed jointly by the structured finance and CBA team on a monthly basis. A bespoke system is used for cash management. This systems also provides inputs for the bond administration calculations which are done using a Microsoft Excel model. All the cash and bond administration models have been independently validated by Deloitte & Touche ("D&T").

There is both an internal and external audit of the CBA function on an annual basis. The external audit is performed by D&T which confirms the redemption fund calculation every year for each transaction. To date no major concerns have been highlighted in any of the external audits.

Fitch is satisfied that the PFPLC team meets the necessary requirements for providing adequate cash/ bond administration services to the transaction.

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.

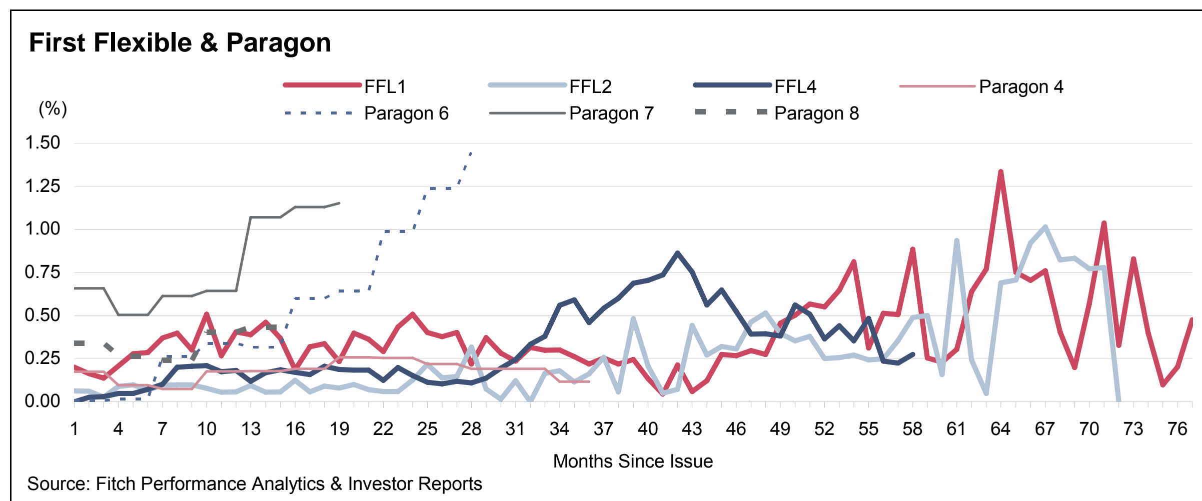
Details of the transaction's performance are available to subscribers at www.fitchresearch.com. Further information on this service is accessible at www.fitchratings.com.

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

Issuer Report Grades

Fitch published the third edition of the Issuer Report Grades (see Fitch's "*Issuer Report Grades May 2006 Update*" report, dated 5 June 2006 and available at www.fitchratings.com). This is part of an ongoing effort to improve the transparency of transaction performance to investors. Transactions are scored on a system ranging from one star (meets basic requirements) to five stars (outstanding). Past Paragon transactions have a current score of four stars, which equates to "Good" meaning the issuer provides good, user-friendly reporting in all areas and meets Fitch's published reporting standards in most areas.

Appendix 1



- First Flexible No. 1 plc: 100% owner-occupied loans originated by First Active Financial UK*. 92% flexible loans.
- First Flexible No. 2 plc: 100% buy-to-let loans originated by First Active Financial UK*. 87% flexible loans.
- First Flexible No. 4 plc: Only 52.1% of the original loan portfolio consisted of buy-to-let loans originated by Britannic Money plc* and First Active plc*. 97.5% of the initial loans were flexible loans.
- Paragon Mortgages (No. 4) plc: 84.3% of the original loan portfolio consisted of buy-to-let loans. Approximately 29% of the initial loans were originated before PML began to focus fully on the professional landlord market.
- Paragon Mortgages (No. 6) plc: 100% PML buy-to-let loans.
- Paragon Mortgages (No. 7) plc: 97.92% of the original loan portfolio consisted of buy-to-let loans originated by PML and MTL.
- Paragon Mortgages (No. 8) plc: 98.73% of the original loan portfolio consisted of buy-to-let loans originated by PML and MTL.

* First Active Financial UK and Britannic Money PLC are previous names of Mortgage Trust Limited

Appendix 2

Issuer

(%)	PM 12	PM 11
WAFF AAA	27.03	27.83
WAFF AA	21.66	22.31
WAFF A	16.27	16.79
WAFF BBB	10.89	11.27
WAFF BB	5.50	5.75
WARR AAA	65.24	64.46
WARR AA	70.45	69.62
WARR A	75.61	74.72
WARR BBB	80.68	79.74
WARR BB	85.65	84.76
Collateral Balance (GBP)	683,388,498	466,153,741
Number of Loans	5,311	3,651
Average CBAL (GBP)	128,674	127,678
Largest CBAL (GBP)	1,939,250	1,913,095
Average Original Valuation (GBP)	165,445	161,755
Largest Indexed Valuation (GBP)*	6,500,000	2,550,000
WA OLTV	80.23	80.66
WA O Comb LTV	80.23	80.66
WA CLTV Indexed*	78.10	78.68
OLTV>80%	68.97	71.12
Self Certified	0.00	0.00
CCJs	0.00	0.00
Bo/IVA	0.00	0.00
IO	93.61	93.39
90+Days in Arrears	0.11	0.23
BTL	100	100
RTB	0.00	0.00
Second-Charge Loans	0.00	0.00
Seasoning (Months)	8.25	8.27
% in London, OM, SE	45.52	49.90
Less Liquid Loans	11.67	10.98
WA Interest Coverage Ratio	127	142
Interest Coverage Ratio >120%	37.52	35.28

* For the purposes of its analysis of the trust property, Fitch assumes the maximum drawable amount for each flexible loan
Source: Fitch

Appendix 3: Rating Methodology

Rating Methodology

When rating a note issuance by a non-conforming mortgage loan issuer, Fitch uses its UK housing recession study as a benchmark (see "*UK Residential Mortgage Default Model III*", dated 26 July 2005 and available at www.fitchratings.com). The study showed that LTV (reflecting the size of a borrower's down payment) and affordability measures proved to be the primary indicators of default risk in the UK. However, pools containing loans made to less creditworthy borrowers require increased scrutiny.

Therefore, Fitch accounts for the additional risks associated with non-conforming borrowers by stressing certain aspects of the model. For instance, default probabilities are increased in cases where a borrower has an adverse credit history, which is typical of non-conforming borrowers as a whole. Furthermore, loss severity is generally higher, owing, in part, to the increased carry cost associated with higher-rate loans.

Default Probability

Generally, the two key determinants of default probability are the borrower's willingness and ability to make the mortgage payments. The willingness of a borrower to pay is usually measured by the LTV, while measures such as debt-to-income ("DTI") ratios indicate the affordability of a loan to a borrower.

Affordability Measures

Fitch's model factors in affordability to calculate overall credit enhancement by using the relevant measure, as provided by the seller. Affordability measures can include income multiples and DTI, and should give an indication of the portion of the borrower's income that will be going to pay the mortgage and other fixed monthly payments. Base default probabilities are determined by using a matrix that considers each loan's affordability factor and LTV. The matrix classifies affordability into seven classes, the lowest of which (Class 1) encompasses loans with income multiples less than 2.0x and the highest of which (Class 7) encompasses all loans with income multiples exceeding 4.0x. Typically, pools of non-conforming loans have a weighted average income multiple of 2.5x, which equates to a base default probability of 6%-44%, depending on LTV.

Loan-to-Value Ratios

Fitch's model assumes higher default probabilities for high-LTV loans and lower default probabilities for low-LTV loans. The main reason for this is that in a severe negative equity situation, borrowers in financial distress but with equity in their homes (low-LTV loans) have an incentive to sell and maintain/protect their equity, eliminating the need for the lender to repossess the property.

Since the inherent risk of lending to non-conforming borrowers is, to some extent, greater than for prime borrowers, lenders usually require a larger upfront equity investment. Therefore, LTVs are generally slightly lower on non-conforming mortgage pools than on prime.

Adjustments to Default Probability

Fitch adjusts the base default rates on a loan-by-loan basis to account for individual loan characteristics of the collateral across all rating levels.

- **Credit History:** a crucial aspect of evaluating a pool of non-conforming mortgage loans is to examine the credit history of the borrower. Namely, adverse credit events such as CCJs or bankruptcy orders, and delinquencies to date can be a harbinger of future loan performance. Even when a borrower's record is currently "clean", the assumed default probability for loans made to borrowers with prior issues is increased. Fitch also focuses on the limits the originators enforced when taking into consideration a borrower's adverse credit history.

- **Loan Purpose:** Fitch believes that a financially distressed borrower is more likely to default on an investment property than on a primary residence. Accordingly, the agency increases the base default rates in such cases by 10%-33%.

- **Borrower Profile:** Fitch increases the default probability on loans to self-certified borrowers by 25%-50% to account for the lack of independent verification of income.

- **Arrears Status:** Fitch penalises, on a loan-by-loan basis, the extent to which a loan is in arrears as of the cut-off date. Default probabilities for loans that are between one day and three months delinquent are increased by 1.25-1.75 times, whereas loans more than three months delinquent are assumed to have a 100% probability of default.

- **Underwriting Quality:** Fitch's review and analysis of the origination process determines whether it decreases default rates by up to 25% or increases them by up to 250%.

Loss Severity

To estimate the loss severity on the loans in a portfolio, Fitch uses its UK default study that examines home price movements in the different regions of the country. By focusing on the recession of the late 1980s/early 1990s, various stressed MVDs were estimated.

When calculating recovery value, Fitch's model reduces each property valuation by the MVD, repossession costs and the costs to the servicer of carrying the loan from delinquency through default.

The agency increases the MVD assumptions for high-value ("jumbo") properties by 10%-30%. Such properties are assumed to have larger MVDs owing to their smaller marketplace and less precise pricing information.

On the basis of worst-case information gathered from UK mortgage lenders, Fitch assumes the fixed costs of foreclosure to be GBP3,000, which includes litigation costs prior to possession, asset management fees, solicitor's fees for the property sale and valuer's fees. Fitch assumes variable costs of 2.5% based on the property value after the MVD, which represents estate agent costs for the sale of the property. To calculate the carrying cost, the agency assumes that the borrower does not pay interest for a period of 18 months on owner-occupied properties and 12 months on buy-to-let properties, and that interest accrues during this period at the current weighted average interest rate of the reference portfolio.

Excess Spread

Excess spread represents the monetary difference between the income received by the issuer from the borrowers and the interest on the notes and other expenses paid by the issuer. Any reserve fund will be replenished from available excess spread if it is drawn. The actual value of excess spread depends on levels of delinquencies, defaults and prepayments, as well as the weighted average interest rate of the reference mortgage portfolio throughout the life of the transaction.

Cash Flow Assumptions

When assessing the credit to be given for potential excess spread throughout the life of the transaction, Fitch makes some key stress assumptions:

- Prepayment rates represent the proportion of the mortgage pool that it is assumed will prepay annually.

- The weighted average coupon ("WAC") compression assumption addresses the risk that high-margin loans will pay off first, resulting in a lower WAC for the remaining pool, and takes the form of a discount applied to the mortgage income received by the issuer from the borrowers (e.g. for 'AAA' rated notes, the weighted average interest rate ultimately received by the issuer from the borrowers is equal to the initial weighted average interest rate minus the WACC assumed for the 'AAA' stress scenario).

- Gross losses are the aggregate expected loss level under the applicable rating stress scenario.

Paragon Mortgages (No. 12) PLC

RMBS/UK

Capital Structure

Class	Rating	Size (%)	Size (GBPm)	CE (%)	Spread	PMT Freq	Maturity	Coupon	ISIN
A1	AAA/F1+	[•]	[•]	15.35	[•]bps	Qtrly Prin/Monthly Int	2038	[•]	[•]
A2	AAA	[•]	[•]	15.35	[•]bps	Qtrly	2038	[•]	[•]
A1 and A2		86.55	1298.25	15.35					
B	AA	7.45	111.75	7.90	[•]bps	Qtrly	2038	[•]	[•]
C	A	6.00	90.00	1.90	[•]bps	Qtrly	2038	[•]	[•]

	Size (%)	Size (GBPm)
Initial Cash Reserve	1.90	28.5
Target Cash Reserve Post Arrears Trigger	2.40	36.0
Step Up Date	August 2011	

AAA 86.55% AA 7.45% A 6.0%

Key Information

Closing Date	[20] July 2006	**Seller/Originator**	PML/MTL
Country of Assets	United Kingdom	**Servicer**	PFPLC/MTS
Issuance Date	[•]	**A1 Note Conditional Purchasers**	Sheffield Receivables Corporation
Structure	Pass Through	**Lead Manager**	Barclays Bank Plc/Deutsche Bank/HSBC Bank Plc
Bloomberg	[ ]	**Standby Mortgage Administrator**	Homeloan Management Ltd
Settlement	Clearstream & Euroclear	**Trustee**	Citibank
Listing	London Stock Exchange	**Account Bank**	National Westminster Bank
Analyst	Ketan Thaker ketan.thaker@fitchratings.com +44 20 7862 4124	**Currency Swap Providers**	Barclays Bank Plc
		Hedge Providers	ABN AMRO Bank and JPMorgan Bank

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 2.40% upon certain events.

A mechanism will be in place (Threshold Interest Margin, "TIM") whereby the originators will extend liquidity to the SPV to stabilise the margin of the collateral at a minimum level of 1.60%

Optional redemption of the notes by issuer if the total outstanding note balance falls below 20% of the note balance at issuance or on the August 2010 interest payment date ("IPD") or any IPD thereafter

Credit Committee Highlights

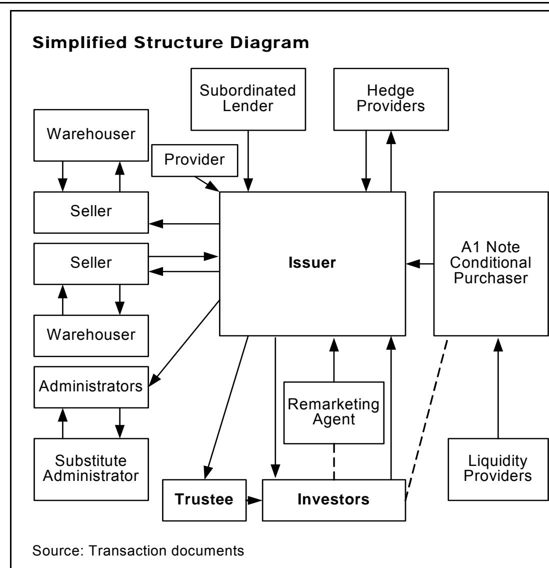
No credit for TIM at 'AAA' level

No credit for subordinated loan

Fitch Default Model Outputs

Rating Level	AAA	AA	A	BBB
WAFF (%)	27.03	21.66	16.27	10.89
WARR (%)	65.24	70.45	75.61	80.68
WALS (%)	41.00	35.79	30.63	25.56
WAMVD	45.03	40.71	36.39	32.03

Simplified Structure Diagram



Source: Transaction documents

Collateral

Pool Characteristics[1]

Current Principal Balance (GBP)	683,388,498	**Regional Concentration (%)**[4]	
Average Current Loan per Borrower (GBP)	128,674	London	24.42
Number of Loans	5,311	Outer Metro	9.65
Seasoning (Months)	8.25	South-East	11.46
Loan to Value (LTV) (%)		North-West	12.27
WA Original LTV	80.23	South-West	10.14
WA Indexed Current LTV[2]	78.10	WA Stabilised Margin over LIBOR	1.63
Mortgage Characteristics			
Self Certification Loans	0.00	Buy to Let	100.00
CCJs	0.00	Purchase	45.18
Bankruptcy Order/IVA	0.00	Remortgage	54.82
Less Liquid Properties[3]	11.67		
Interest-Only Loans and Partial Repayment	93.61	**Arrears**	
Interest Rate Type (%)		0-30 Days	0.39
Discount	12.73	31-60 Days	0.15
Variable	17.57	61-90 Days	0.16
Fixed	69.71	> 90 Days	0.11

[1] For the purposes of its analysis of the trust property, Fitch assumes the maximum drawable amount for each flexible loan
[2] 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 28 April 2006 provided by Paragon Finance plc.

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