STANDARD & POOR'S

Structured Finance

PRESALE REPORT

This presale report is based on information as of February 28, 2000. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings. Please call Standard & Poor's at (44) 171-826-3540. for the final ratings when assigned.

Profile

Expected closing date:
Feb. 29, 2000.

Collateral:
A pool of first ranking mortgages secured over freehold, leasehold, or feudal properties located in England, Scotland, and Wales.

Lead manager:
ING Barings Ltd.

Originator:
Paragon Mortgages Ltd.

Administrator:
Paragon Finance PLC.

Security and note trustee:
Citicorp Trustee Co. Ltd.

Swap counterparty:
Morgan Guaranty Trust Co. of New York.

Bank account provider:
National Westminster Bank PLC.

Substitute administrator:
RFC Mortgage Services Ltd.

Supporting ratings:
Morgan Guaranty Trust Co. of New York (AA/A-1+); National Westminster Bank PLC (AA/A-1+).

Analyst:
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Paragon Mortgages (No. 2) PLC

£185 million floating-rate notes

Preliminary ratings as of February 28, 2000

Class	Preliminary rating*	Preliminary amount (Mil. £)	Recommended credit support (%)
Class A mortgage-backed floating-rate notes due 2030	AAA	166.5	12.7
Class B mortgage-backed floating-rate notes due 2042	A	18.5	2.7

*The rating of each class of securities is preliminary and subject to change at any time.

Rating Rationale

The 'AAA' preliminary rating assigned to the £166.5 million class A mortgage-backed floating-rate notes and the 'A' preliminary rating assigned to the £18.5 million class B mortgage-backed floating-rate notes issued by Paragon Mortgages (No. 2) PLC reflect the ability of the servicer to perform its roles in this transaction; the sound legal structure of the transaction; and the sound payment structure and cash flow mechanics of the transaction.

Further key considerations include the strong protection for class A noteholders provided by a combination of the subordinate class B notes (10% of the notes issued), the first-loss fund (2.7% of the notes issued), and excess spread to cover credit losses and income shortfalls; and the strong protection for class B noteholders provided by the first-loss fund and excess spread to cover credit losses and income shortfalls.

Final ratings are expected to be assigned on the closing date subject to satisfactory review of all documentation and legal opinions.

Main Transaction Parties

Paragon Mortgages (No. 2) PLC (Issuer)

The issuer is a public company incorporated under the laws of England and is a subsidiary of The Paragon Group of Companies PLC (PGC). The ordinary shares of PGC are listed on the London Stock Exchange.

The issuer is a special-purpose entity (SPE) established for issuing the notes, purchasing the issuer mortgages, and making term loan advances under the Luxembourg Loan Agreement (*see below*).

Paragon Mortgages (No. 3) S.A. (PSA3)

Paragon Mortgages No. 3 was incorporated as an SPE in Luxembourg on Jan. 26, 2000. It is a subsidiary of PGC and on the closing date will acquire the beneficial interest in mortgages from Paragon Finance PLC and will enter into a loan agreement with the issuer (the Luxembourg Loan Agreement).

The issuer and PSA3 are designed as bankruptcy-remote, special-purpose entities that conform to Standard & Poor's SPE requirements.

Paragon Mortgages Ltd. (PML) (Originator)

Paragon Mortgages Ltd. is a private company incorporated in England. PML is the originator of the mortgages in the portfolio, either directly or indirectly via broker intermediaries.

Citicorp Trustee Co. Ltd. (Trustee)

The trustee's role is to supervise the administrator in its administration of the issuer under the terms of the transaction and to generally represent and protect the interests of noteholders. Only the trustee will be able to enforce the security under the terms and conditions of the notes and it will always have to act in the best interests of the noteholders.

Morgan Guaranty Trust Co. (Interest Rate Swap Counterparty)

The issuer will enter into the mortgage rate swap agreement with Morgan Guaranty Trust Co. to protect the issuer and noteholders from variations between the interest rate received on the mortgages and the interest rate due on the notes. The transaction will provide that the issuer will only be required to pay any swap breakage costs owed to the swap counterparty at a level subordinated to payments of class B payments in the priority of payments but will be allowed to retain the benefit of any swap breakage income in its favor. The mechanism functions similar to the benefit of an interest rate cap in the issuer's favor.

Paragon Finance PLC (PFPLC) (Administrator and Subordinated Loan Provider)

As administrator, PFPLC will be responsible for the day-to-day administration and ongoing servicing of the underlying portfolio of mortgages. PFPLC is also responsible for producing all reports and accounts for the trustee and Standard & Poor's in connection with the performance of the mortgages.

A review of PML's origination, underwriting, and valuation processes has been conducted as well as PFPLC's (as administrator) collection and default management procedures. Such a review is an integral part of the corporate overview undertaken during the rating process of any transaction and is maintained throughout the life of the transaction. PFPLC is deemed capable of performing the functions necessary to ensure the collection of borrower payments and management of the arrears and repossession cases.

PFPLC will provide a subordinated loan to the issuer which will fund the first-loss fund—a cash reserve forming part of the credit enhancement for the notes. Step-down of the first-loss fund will be allowable after five years from the closing date subject to the balance of the fund being no less than 5.4% of outstanding notes, with a floor of the greater of £500,000 and twice the principal amount of the largest remaining mortgage loan.

National Westminster Bank PLC (Transaction Account Provider)

National Westminster Bank PLC will provide the transaction account for this transaction. All payments from borrowers will be paid into a collection account which is also held with National Westminster Bank and then transferred to the transaction account.

Transaction Structure

At closing, and in accordance with the terms of a mortgage sale agreement, the issuer will acquire from PFPLC the beneficial interest in certain mortgages (termed issuer mortgages) originated by PML, which will form part of the security for the notes. The borrowers in respect of the issuer mortgages are individuals. Part of the note proceeds will be used to establish a prefunding reserve in an amount of approximately £27 million. Up until the first principal determination date, the issuer may use the prefunding reserve to purchase further mortgages from PML, subject, among other things, to Standard & Poor's being satisfied that the purchases will not adversely affect the existing note ratings. Any amounts outstanding in the prefunding reserve beyond May 31, 2000 will be applied in redemption of the class A notes.

At closing, PSA3 will acquire the beneficial interest in a pool of mortgages from PFPLC which have been originated by PML. The borrowers in respect of these mortgages are limited liability companies incorporated in England and Wales or Scotland. PSA3 will fund the purchase of the mortgages from the proceeds of a loan to PSA3 by the issuer, which in turn will be funded contemporaneously from part of the note proceeds. The issuer loan to PSA3 will be made in accordance with the terms of the Luxembourg loan agreement. The PSA3 mortgages will form part of the security for the issuer (and ultimately the noteholders) under the terms of the loan agreement.

Both classes of notes will be secured on all the mortgages and repayments to noteholders will derive from the issuer mortgages and also from the PSA3 mortgages.

Note Terms and Conditions

The issuer is expected to issue two classes of notes, the class A notes ('AAA') and the class B notes ('A'). The class A notes will rank senior to the class B notes.

Interest on the class A notes will be payable at three-month British pound sterling LIBOR plus a margin of 0.30% per year, stepping up to a margin of 0.60% per year after March 2006. Interest on the class B notes will be payable at three-month British pound sterling LIBOR plus a margin of 0.875% per year, stepping up to a margin of 1.75% per year after March 2006. Interest on the notes will be payable quarterly in arrears on the 15th of March, June, September, and December each year, commencing on June 15, 2000.

Mandatory Redemption

The notes will be subject to mandatory redemption in part on each interest payment date from available funds. There will be no mandatory redemption of the class B notes for the first five years from the closing date. Thereafter, while class A and B notes remain outstanding, redemption will be applied on a pro rata basis, subject to:

- The ratio of class B notes to the aggregate of outstanding class A and B notes being no less than twice the ratio at closing;
- There being a zero balance on the principal deficiency ledger; and
- The minimum outstanding amount of class B notes is £8.5 million while any class A notes remain outstanding.

Optional Redemption

The issuer may redeem all (and not some only) of the notes at their outstanding principal amount together with accrued interest under the following circumstances:

- A withholding tax is imposed on the notes or on payments by either party to the swap agreement; and
- The aggregate principal amount outstanding of the notes becomes less than 20% of the original principal amount of the notes (including the original principal amount of any further notes issued).

The issuer may also redeem the notes on the interest payment date in March 2003 or at any time thereafter.

Final Redemption

If not already redeemed, the class A and class B notes will be redeemed at their legal final maturities in June 2030 and June 2042 respectively.

Withholding Tax

The issuer will not be required to gross up for any withholding tax that might be imposed on the notes in future.

Collateral Details

Collateral Description

The provisional mortgage pool of £149,157,351.93 comprises 2,743 loans and was drawn up on Jan. 31, 2000. The loans in the provisional portfolio were originated by PML between Oct. 1, 1997 and Jan. 31, 2000 and have been administered by PFPLC since origination. Features of the final mortgage pool include:

- Each loan is secured by a first legal charge of a residential property in England, Scotland, and Wales;
- Of the total pool, 92.36% are buy-to-let mortgages, with the remainder being owner occupied;
- Of the total mortgages, 43.2% are capital repayment mortgages, and 56.8% are interest-only mortgages;
- Of the total loans, 60.65% were used for house purchases and 39.35% were used for remortgage;
- The weighted average loan-to-value (LTV) of the mortgage pool is 73.62%;
- The average outstanding mortgage balance is £54,377;
- The largest concentration of mortgages by geographic area is in the South East of England (including London at 55.61%) there are no significant concentrations in other regions;
- The weighted average term to maturity is approximately 19.53 years.

Standard & Poor's Stress Test

The analysis includes a conservative assessment of the credit risk inherent in the transaction. The credit enhancement levels have been sized after analyzing the impact that severe stress scenarios would have on the collateral. In determining the credit quality of a mortgage pool, an estimate must be made of a worst case of potential losses that could occur because of foreclosures. This estimate of potential losses is the amount of loss protection needed. All types of loans are thus eligible for inclusion in a pool, provided their credit risk can be quantified and adequate loss protection is supplied.

A feature of the portfolio is the high level of different types of buy-to-let mortgages. These include professional, corporate, and amateur lettings. The levels of underwriting by the originator are considered to be conservative, but the characteristics of the buy-to-let market create additional risks relative to a typical prime mortgage portfolio, notwithstanding the weighted average LTV of this portfolio.

The cash flows simulate the performance of this portfolio in the transaction's documented structure under certain stressful scenarios. In addition, the issuer will make use of the swap to prevent mismatches in interest rates. Any bank accounts of the issuer are required to be with appropriately rated providers.

Surveillance Details

Continual surveillance will be maintained on the transaction until the notes mature or are otherwise retired. To do this, regular reports detailing the performance of the underlying mortgages will be produced, supporting ratings will be monitored, and regular contact will be made with the servicer to ensure minimum servicing standards are being sustained. The servicer is also expected to highlight any new developments in its situation in a timely manner.