Paragon Mortgages (No.17) PLC

Presale

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Deal Compare

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Capital Structure

Class	Rating	Outlook	Amount (GBPm)	CE[c] (%)	Final Maturity	TT[a] (%)	TTLM[b]
A	AAAsf	Stable	TBD	15.50	Apr 2040	TBD	TBD
B	AAsf	Stable	TBD	10.25	Apr 2040	TBD	TBD
C	Asf	Stable	TBD	5.25	Apr 2040	TBD	TBD
D	NR	n.a.	TBD	3.0	Apr 2040	n.a.	n.a.
Total Issuance			TBD				

Expected ratings do not reflect final ratings and are based on information provided by the issuer as of 30 September 2012. These expected ratings are contingent on final documents conforming to information already received
[a] Tranche thickness percentage - ratio of class size to collateral balance
[b] Tranche thickness loss multiple - TT% divided by Fitch's base case loss expectation. See also *Structured Finance Tranche Thickness Metrics*, 29 July 2011
[c] Credit enhancement – The actual credit enhancement could be different from that modelled and the final capital structure will be assessed before assigning final ratings.

Transaction Summary

Fitch Ratings has assigned expected ratings to the residential mortgage-backed notes issued by Paragon Mortgages (No.17) PLC (PM17), an SPV incorporated in England and Wales. PM17 is a wholly owned subsidiary of The Paragon Group of Companies PLC (PGPLC).

The pool of loans backing the notes consists of UK prime buy-to-let (BTL) residential mortgages, originated by Paragon Mortgages 2010 Limited (Paragon). The loans are serviced by Paragon Finance plc as delegated by Moorgate Asset Administration Limited (Moorgate), with Homeloan Management Limited (HML) acting as a back-up servicer.

Key Rating Drivers

Buy-to-Let Poses Arrears Risk: The portfolio consists entirely of BTL loans. Fitch continues to stress the portfolio's default rates beyond those of a prime owner-occupier portfolio at all rating levels, despite the historically lower arrears of past Paragon deals compared to many prime portfolios.

Non-Orphan SPV: PM17 is 100% owned by PGPLC. Since the issuer in this case is not an orphan vehicle, it is possible that under certain circumstances the issuer may become liable under UK tax laws for the tax liabilities of other entities in PGPLC. Fitch believes the risk of such a liability being assessed against PM17 is limited.

Pre-Funding Period: Prior to the second principal determination date on 28 March 2013, about GBP56.0m of additional loans will be added to the pool. Any balance remaining to the credit of the pre-funding ledger after this period, not used to purchase additional loans, will be used to pay down the notes sequentially.

Sequential Structure: The class A, B and C notes benefit from a sequential structure. Interest to the class D bonds is subordinated to the class A, B and C interest principal deficiency ledger (PDL) and the reserve fund, increasing the excess spread available to cover for losses related to the class A notes.

Minimum Mortgage Rate: The administrator must ensure a minimum mortgage rate (including inflow from hedges, other income and the margin reserve fund). Fitch has given no credit to this feature in its cash flow analysis.

Key Parties

Issuer: Paragon Mortgages (No.17) plc

Originator: Paragon Mortgages (2010) Limited

Seller: Paragon Mortgages (2010) Limited

Servicer: Paragon Finance plc (as delegated by the administrator, Moorgate Asset Administration Limited)

Back-up Servicer: Homeloan Management Limited (RPS2)

Administrator: Moorgate Asset Administration Ltd

Trustee: Citicorp Trustee Company Limited

Subordinated Lender: Paragon Finance PLC

Account Bank: National Westminster Bank plc ('A'/Stable/'F1')

Collection Account: National Westminster Bank plc ('A'/Stable/'F1')

Principal Paying Agent: Citibank, N.A., London Branch ('A'/Stable/'F1')

Swap Provider: Macquarie Bank Limited, London Branch ('A'/Stable/'F1')

Arranger: Macquarie Bank Limited, London Branch

Joint Lead Managers: Lloyds TSB Bank plc**,** Macquarie Bank Limited and Morgan Stanley & Co. International plc

Related Criteria

EMEA Residential Mortgage Loss Criteria (June 2012)

EMEA Criteria Addendum - United Kingdom - Mortgage Loss and Cash Flow Assumptions (August 2012)

EMEA RMBS Master Rating Criteria (June 2012)

EMEA RMBS Cash Flow Analysis Criteria (June 2012)

EMEA Cash RMBS Structural Overview (May 2009)

Counterparty Criteria for Structured Finance Transactions (May 2012)

Counterparty Criteria for Structured Finance Transactions: Derivative Addendum (May 2012)

Criteria for Servicing Continuity Risk in Structured Finance (August 2012)

Representations, Warranties, and Enforcement Mechanisms in Global Structured Finance Transactions (April 2012)

Structured Finance Tranche Thickness Metrics (July 2011)

Rating Sensitivity[1]

This section of the report provides an insight into the model-implied rating sensitivities to hypothetical changes in defaults and/or recoveries on the assets in a stressed environment. These increased defaults and/or recoveries on assets are relative to the dynamic weighted average frequency of foreclosure (WAFF) of the mortgage portfolio (20.6% for the 'AAAsf' rating scenario) and the dynamic weighted average recovery rate (WARR) of the mortgage pool (48.5% for the 'AAAsf' rating scenario), respectively; they are assumed to occur immediately after closing of the transaction. The model-implied rating sensitivities, based on such assumptions, are only indicative of some of the potential outcomes and do not consider other risk factors to which the transaction is exposed.

Rating Sensitivity to Defaults

	Class A	Class B	Class C
Original rating	AAAsf	AAsf	Asf
15% increase in default rates	AAAsf	AAsf	A-sf
30% increase in default rates	AA+sf	AA-sf	A-sf

Source: Fitch

Rating Sensitivity to Recovery Rates

	Class A	Class B	Class C
Original rating	AAAsf	AA	A
15% decrease in recovery rates	AAAsf	AA	A-
30% decrease in recovery rates	AA+sf	AA-	BBB+

Source: Fitch

Rating Sensitivity to Shifts in Multiple Factors

	Class A	Class B	Class C
Original rating	AAAsf	AA	A
15% increase in default rates, 15% decrease in recovery rates	AA+sf	AA-	BBB+
30% increase in default rates, 30% decrease in recovery rates	AAsf	A	BBB

Source: Fitch

Model, Criteria Application and Data Adequacy

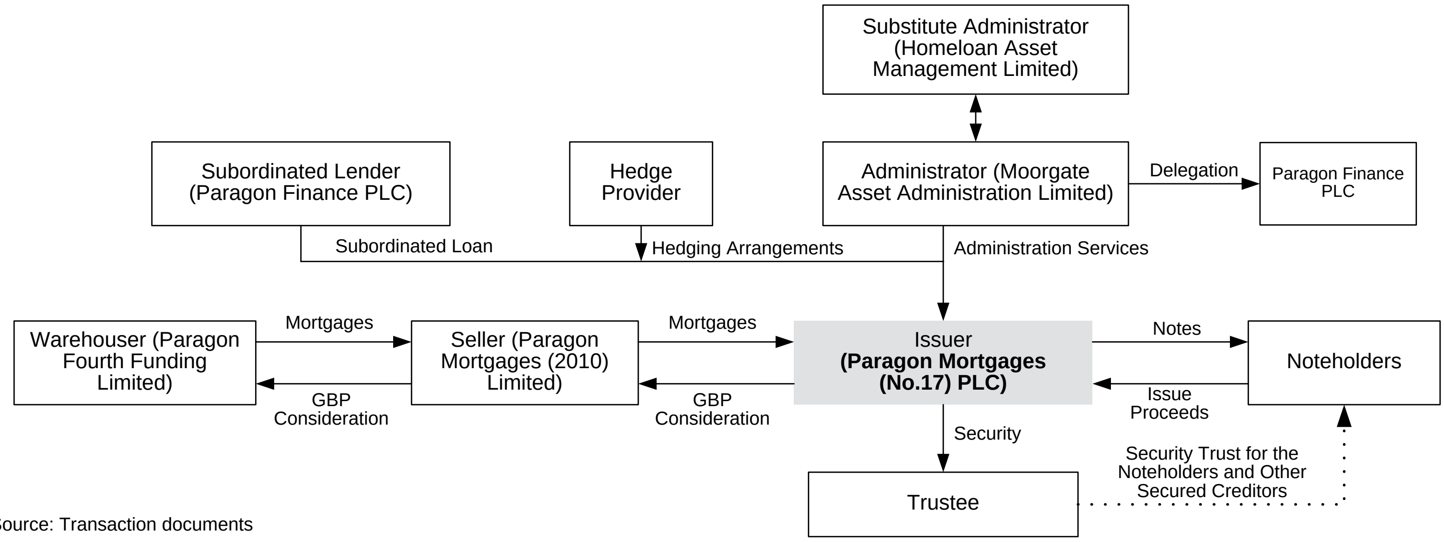
Fitch analyses the collateral for UK residential transactions using a country-specific, loan-by-loan mortgage default model. The model subjects the mortgage loans to stresses based on Fitch's assessment of historical house price movements and mortgage defaults in the UK. The agency's study showed that a borrower's loan-to-value ratio (LTV), reflecting the size of their down-payment and their willingness to pay, and a borrower's debt-to-income (DTI) ratio or income multiple, reflecting their ability to pay, to be the key determinants of default probability in the UK.

Paragon provided Fitch with a loan-by-loan data template. Fitch carried out a file review of selected loans in the pool and found no material issues. All the loans in the pool (except one) were originated in 2011 and 2012, thus Fitch believes that the majority of original valuations provide conservative original loan-to-value (OLTV) levels for the mortgage portfolio

Repossession data based on over 4300 loans originated between 2003 and 2012 was also provided. The data includes loans where Paragon has appointed Receiver of Rent. Fitch has excluded loans for which a RoR has been appointed and loans where sufficient data is not available for calculating the Quick Sale Adjustment (QSA) for PM17.

[1] These sensitivities only describe the model-implied impact of a change in one of the input variables. This is designed to provide information about the sensitivity of the rating to model assumptions. It should not be used as an indicator of possible future performance

Figure 1
Structure Diagram



Source: Transaction documents

Transaction and Legal Structure

Legal Framework

PM17 (the issuer) is 100% owned by The Paragon Group of Companies PLC (PGPLC). Since the issuer in this case is not an orphan vehicle, it is possible that under certain circumstances the issuer can become liable under UK tax laws for certain UK tax liabilities of other entities which are, or have been, members of the same group as the issuer for UK tax purposes. However, based on the undertakings from the ultimate holding company PGPLC (see below) and the representative member of the Paragon VAT group, Paragon Finance PLC (PFPLC), whose general enforceability has been confirmed by the transaction legal opinion, subject to reservations typically stated with respect to enforceability, Fitch believes the risk of such a liability being assessed against PM17 is limited.

The issuer, PM17, is also currently part of the Paragon VAT group. Under UK VAT law, each member of a VAT group is jointly and severally liable for any VAT due from the representative member of the group (here PFPLC) in respect of supplies made to or by the group. To reduce the risk of the issuer becoming liable for the VAT liabilities of the Paragon VAT group, the following mitigants have been put in place.

- PFPLC has agreed in the transaction documents that it will assist in the making of the necessary application to HMRC to effect the de-grouping of the issuer from the Paragon VAT Group. Once the issuer's degrouping is effective, it would cease to be jointly and severally liable for VAT due from PFPLC as the representative member of the Paragon VAT group; however, the issuer would continue to be jointly and severally liable for any VAT liability of PFPLC, as the representative member of the Paragon VAT Group, which arose during the issuer's period of membership of the Paragon VAT group.
- Funds in a trust account can be accessed by certain members of the Paragon VAT group (including the issuer) to meet a VAT liability, should the entity which is primarily liable for making the VAT payment fail to make the payment. The amount held in the account is determined and maintained on a quarterly basis by PFPLC and would be the greater of: (i) GBP120,000; or (ii) 120% of the actual VAT liability of the Paragon VAT group in the past two accounting periods; or (iii) 120% of the sum of the estimated VAT liabilities of the Paragon VAT group for the current and next succeeding accounting periods.

PM17, as a member of a group of companies of which PGPLC is the ultimate parent, could also be liable for certain non-VAT UK tax liabilities and pension liabilities of the other companies in the group. For example, where a company which is a member of a group fails to discharge certain of its UK tax liabilities within a specified period of time, other members of the same group may, in certain circumstances, become secondarily liable for the unpaid tax of that company. PGPLC has given various undertakings and warranties in the transaction documents (in particular, in the Tax Deed of Covenant) to the effect that it would not take actions (and has not previously taken any action) and will procure that no action is taken that would cause a secondary non-VAT tax liability to be assessed against PM17. These also include a covenant to indemnify PM17 against certain non-VAT tax liabilities for which it becomes secondarily liable.

Fitch has been advised that the risk of the issuer becoming liable for unpaid taxes of the Paragon group will depend on the facts and circumstances of the other group companies. However, the secondary non-VAT tax liabilities under the “change of ownership” rules in Chapter 6, Part 14 of the Corporation Tax Act 2010 (which is one of the main provisions under which a secondary liability can attach to a company) are generally aimed at situations where there is an unpaid corporation tax liability in a company, as a result of a tax avoidance scheme. HMRC has previously stated it is unlikely to apply those provisions unless the circumstances involved a tax avoidance scheme, having regard to the provisions’ overall purpose of catching persons involved in tax avoidance and tax evasion.

On the basis of its review of the transaction documents and the transaction tax opinions, and responses to various questions raised by Fitch in the course of its analysis, Fitch is not aware of any tax avoidance scheme relevant to the rated notes. As PM17 is in the same corporate group as PGPLC’s “trading” subsidiaries, and the Paragon group operates a defined benefits occupational pension scheme, it is likely an “associate” of those companies for purposes of the UK Pensions legislation. It is therefore possible that the UK Pensions Regulator could issue a financial support direction or contribution notice ordering PM17 to contribute to any shortfall in the Paragon Group defined benefits occupational pension scheme, should the Paragon group company which is the "employer" under the defined benefits occupational pension scheme become insolvent and there is a deficit in the scheme as at the date of the insolvency (the so-called "section 75 debt", which is a reference to the crystallisation of a debt representing the deficit effected pursuant to section 75 of the Pensions Act 1995).

As all of Paragon's financing SPVs are group companies, there may be a higher risk of an approach by the Pensions Regulator if it is of the view that Paragon's business has been deliberately structured to limit the access which group companies have to financing vehicles which generate cash.

While PM17 is more likely than a typical orphan SPV to be served with a financial support direction or contribution notice with respect to a section 75 debt, Fitch believes that it remains unlikely on the current facts (including the limited involvement PM17 has had and should have (assuming its compliance with the transaction documents) in the future with other group companies) and given the approach taken to date by the Pensions Regulator in connection with financial support directions and contribution notices, that such a direction or notice would be issued.

If PM17 goes into administration or liquidation, and the pensions regulator subsequently serves a financial support direction or contribution notice on PM17, then, under current UK law, PM17’s liability under the financial support direction or contribution notice would rank as an expense of the administration or liquidation and so would be payable out of floating charge assets of PM17, but not fixed charge assets.

To the extent that PM17’s notes are secured by fixed security interests, noteholders’ claims should have priority over PM17’s liability under the financial support direction or contribution notice. As is typically the case with English law opinions on the nature of security interests, and in particular whether a security interest will take effect as fixed security or a floating charge, the transaction legal opinion does not specify whether the security granted by PM17 over its asset will take effect as fixed security interests or floating charges.

If directors of another Paragon Group company who also sit on the Board of PM17 were to resign due to a conflict of interest at a time when the Paragon Group or PM17 was undergoing financial difficulties, the resignations could delay the taking of actions by PM17 to mitigate its potential liability for the obligations of other companies in PGPLC and/or to address its financial difficulties. Fitch considers that the risk of this delay has been mitigated as the Board of Directors of PM17 has two independent directors and only two directors are required for a quorum at a Board of Directors meeting; thus ensuring PM17 would incur no delay in taking key decisions relevant to Fitch's analysis.

On the closing date, the loan seller will assign the rights, title and interest in and to the mortgages to PM17 (a public company incorporated under the laws of England and Wales). There will be no recourse to the seller (except with respect to loans sold in breach of warranty) so that the transfer to PM17 is treated as a true sale.

At closing, PM17 will enter into a deed of charge, creating security over its assets in favour of the trustee as security for all payments under the notes. The security will include first-ranking sub-mortgages and first-ranking fixed charges in favour of the trustee over all the issuer's rights, claims, title, benefit and interest in and to the underlying collateral.

The transaction has a pre-funding period in which Paragon may sell further loans to PM17, subject to certain conditions, including:

- a certificate of a director of the seller confirming that the additional mortgages were originated in accordance with applicable lending guidelines;
- no enforcement notice has been served on the issuer;
- no event of default of the notes has occurred; and
- each of the mortgage condition tests mentioned in the transaction documents are satisfied.

Representations and Warranties

The mortgage sale agreement contains representations and warranties given by the originators in relation to the pool of mortgages. No search of title has been conducted by the issuer or the trustee; rather they have relied 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:

- no lien or right of set-off exists between the mortgagee and any borrower;
- the maximum LTV (excluding fees) for a loan size up to GBP500,000 is 75% and for a loan size up to GBP1,000,000 it is 70%;
- multiple applications for BTL properties have been considered up to a total of GBP5,000,000 per borrower;
- in the event that the first two payments due in respect of any mortgage have fallen due and have not been received in full the issuer shall sell and the seller shall repurchase or procure the repurchase of the mortgage concerned; and
- as at the relevant purchase date, the maximum aggregate principal amount of all arrears mortgages which may be purchased by the issuer is GBP1,000,000.

Further Advances

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, amongst others:

- there was no debit balance on the principal deficiency ledger (PDL) as at the previous interest payment date;
- the reserve fund is at its required amount;
- 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.

Disclaimer

For the avoidance of doubt, Fitch relies, in its credit analysis, on legal and/or tax opinions provided by transaction counsel. As Fitch has always made clear, Fitch does not provide legal and/or tax advice or confirm that the legal and/or tax opinions or any other transaction documents or any transaction structures are sufficient for any purpose. The disclaimer at the foot of this report makes it clear that this report does not constitute legal, tax and/or structuring advice from Fitch, and should not be used or interpreted as legal, tax and/or structuring advice from Fitch. Should readers of this report need legal, tax and/or structuring advice, they are urged to contact relevant advisers in the relevant jurisdictions.

Asset Analysis

Lender Adjustment

Fitch's base default probabilities assume that origination, underwriting and servicing practices and procedures are in line with those of a standard traditional UK mortgage lender with market expertise, financial stability and relevant management experience.

As part of the analysis, the agency performs an operational review of the originator to assess the origination, underwriting and servicing capabilities of the seller. As a result of this review, if Fitch believes that origination, underwriting and servicing procedures are below market standards, an adjustment to the base default probabilities of the whole portfolio is warranted. The relevance of this adjustment is further sized by considering certain elements that cannot be factored into the analysis on a loan-by-loan basis, either because they are not available or because they are only applicable on an aggregate basis.

As mortgage companies, Paragon and Mortgage Trust Limited (MTL – wholly owned by PGPLC) specialise in the origination of BTL products through intermediaries, and since February 2001 the vast majority of originations have been to professional BTL investors. To qualify for the benefits of such a loan a borrower must already possess a portfolio of at least three properties and must present a minimum of two years financial accounts for the underwriters to scrutinise. Such professional BTL investors 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, the rental income from single, self-contained properties must be a minimum of 125% of the mortgage payment calculated on an interest only basis, at either the product rate, or a reference rate of 5%, whichever is the higher. The rental income for all other property types must be a minimum rental income of 130% of the mortgage payment calculated on an interest only basis, at either the product rate, or the reference rate of 7%, whichever is the higher.

Fitch has considered several strengths and concerns in its lender adjustment (see also *Appendix B - Origination, Underwriting and Servicing*).

Among others, the main concerns are as follows: (1) Paragon is a niche market lender and this market has decreased over the last several years. Demand for such products could result in an acceptance of lesser quality loans or applications being agreed or received, however this can be mitigated by the low arrears levels evidenced; (2) only intermediary business is accepted as Paragon does not have a high street presence, although this is mitigated by the quality and experience of intermediaries on the robustly controlled panel.

In Fitch's view, strengths to consider are as follows: (1) Paragon has an excellent track record with very low levels of arrears and this is assisted by a thorough understanding and application of the receiver of rent policy; (2) affordability is stressed significantly over the current pay rate; (3) all mortgage applications require a full valuation.

It is also important to note that, given the current state of the mortgage market, it is difficult for buyers to secure mortgages due to tighter lending criteria and limited product availability. This has, and quite possibly will for the foreseeable future, cause borrowers to remain in their current rental agreement(s) thus increasing the demand for rental properties and leading to an increase in rents by landlords. This will, and has, caused an increase in revenues for professional landlords and reduced the arrears rates in BTL securitisations. Potential interest rate rises will be the biggest single risk factor.

Buy-To-Let

The loans in the pool consist entirely of prime BTL loans. Fitch considers loans on BTL properties to be inherently more susceptible to default than those secured on an owner-occupied property due to 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.

One important mitigating feature of BTL loans is that, upon default, the foreclosure process is quicker than for owner occupied properties, as tenants with short-hold tenancy agreements can generally be more easily evicted than owner-occupiers, while the repossession process through the courts is shorter.

In addition, Fitch has noted that a high proportion of the borrowers in this pool are professional landlords, with a minimum of 24 months' experience of managing at least three properties and with a recognised aptitude for enforcing tenancy contracts. The remaining BTL borrowers are private investor landlords, also with significant experience who aim to stay in the market long term.

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.

For BTL properties a receiver of rent process (ROR) can be used to manage repossessed properties. Following the appointment, the ROR will directly collect rent from paying tenants and pass it to the lender to pay down any arrears. This helps maintain the rental income stream and would thus keep a steady flow of cash to the transaction.

Interest-Only Loans

93.88% of the loans in the provisional pool are interest only, which is typically the loan-vehicle favoured by BTL borrowers. 59.1% of the loans in the pool revert to repayment after year five.

Interest-only loans can be construed to be riskier than amortising loans because of the greater risk that the borrower may be unable to repay the debt in full at maturity (ie balloon payment risk). However, interest-only hits will ordinarily not apply to BTL products as the BTL market is almost entirely interest-only which is factored into the general BTL product adjustments. The risk in this transaction is further mitigated by the fact that the borrowers are predominantly professional landlords with a demonstrated ability to manage a property with an interest-only loan, and given the strong historic performance on previous Paragon transactions.

In light of the mitigants above no adjustment has been made to interest-only loans in this pool.

Concentration Risk

The small initial portfolio size at closing could potentially lead to two levels of concentration risk in this transaction.

The first emanates at the loan level where any single loan could potentially cause disproportionately larger losses than would be the case in a larger more diversified pool. The second relates to Paragon's business model of targeting professional landlords who typically have a number of BTL loans with Paragon. Hence if one landlord has a number of loans in the pool, each one not large in itself, the total exposure could become significant.

Fitch also considers the level of concentration in the transaction's mortgage portfolio to be a key factor in the assessment of tail risk within a particular transaction.

Rent of Receiver (ROR)

Fitch believes the risk of exposure to a single loan or borrower is mitigated to a large extent by Paragon's reliance on the ROR process. If Paragon believes a borrower is struggling it will appoint a ROR on the entire portfolio of the borrower, which does not require court approval. They will send a surveyor with a property agent to the property and inform the tenant that they have to send their rent to the ROR, who forwards it on to Paragon, instead of paying the landlord and no monies from that point onwards are allowed to be passed on to the borrower. Any payments received in excess of monthly mortgage payments are used to prepay the loans. Where the property is vacant a decision is made to rent or sell the property and a locksmith will also change the locks to the property.

This is a process Paragon initiates early on (typically within two months) as part of a pro-active approach to monitoring and managing arrears. Paragon holds discussions with borrowers, who have been identified as struggling to keep up with payments, regarding their current financial situation and then assess their ability to continue managing the property effectively.

Even if a borrower becomes current at a later date, Paragon is not obliged to release the property back to the borrower, which could effectively force a borrower to redeem all the mortgages with PML.

Self-Employed Borrowers

73.6% of borrowers in this pool are self-employed. These are typically professional landlords who rely solely on rental income for their earnings. Given the demonstrated ability of professional landlords to manage a property (based on the previous performance of Paragon transactions) no adjustment was made for borrowers designated as self-employed in this pool.

Illiquid Properties

37.7% of the loans fall into Fitch's jumbo and small categories, which represent property values at the less liquid ends of the property market.

Historical portfolio performance in most countries typically shows that high-value and low-value properties tend to realise higher than average relative losses, even in times of low stress in the housing market.

Where a property value is classified as high or low, Fitch will reduce the distressed property value after deduction of the MVD by an incremental illiquidity adjustment factor. These illiquidity adjustment factors are derived by rating scenario, with a larger haircut applied to the distressed property value (i.e. after indexation and MVD) in more stressed scenarios.

Quick Sale Adjustment

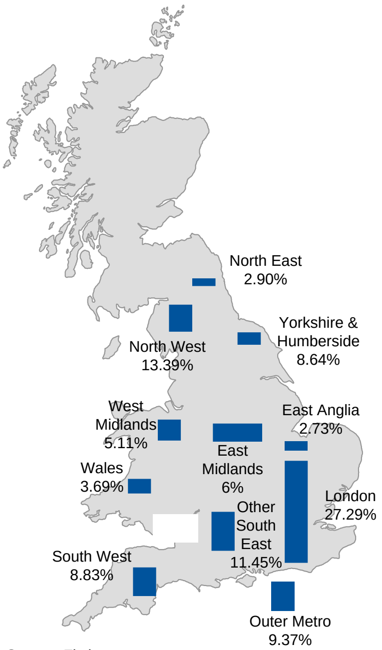
The Market Value Decline (MVD), which reflects Fitch's view of each region's vulnerability to house price declines, and reflects historical experience and socioeconomic factors, also incorporates a QSA. This is the discount a seller is likely to have to suffer for selling a property in a depressed market; often reflecting non-marketable conditions. Professional landlords also tend to modify properties in order to maximise rental yields which can affect the market value of the properties, or use additional revenue to undo the modifications, when it comes to a sale. The QSA is the same across all regions and rating scenarios.

The QSA, calculated using the repossession data provided by Paragon, was approximately 32%, which was higher than Fitch's criteria assumption of 22%. Fitch has therefore increased the assumptions for the QSA for PM17. The repossession data is based on over 4300 loans covering the period 2003 to 2012. The agency calculated QSA based on 1170 loans after excluding loans on the basis of insufficient data and RoR arrangements.

Figure 2

Geographic Breakdown Location

As of September 2012



Source: Fitch

Geographical Concentration

The mortgage portfolio is skewed towards the London and the South East (see chart). 49.1% of the properties in the mortgage portfolio are located in London/South East/Outer Metro.

Default Model Output

The following table illustrates the asset analysis results across different rating scenarios. Fitch has used these WAFF and WARR levels when modelling the transaction cash flows.

The transaction has a pre-funding period in which Paragon will sell further loans to PM17, subject to the conditions including those described above in the *Transaction and Legal Structure* section. Fitch generally expects some limits to be defined in the transaction documentation relating to WA OLTV, CLTV and ICR to mitigate any risk of negative portfolio migration during the pre-funding period. Paragon has included limits on WA ICR, WA CLTV and WA OLTV. WA OLTV and WA CLTV will not be greater than 70.5%. The agency has used these weighted-average foreclosure frequency (WAFF) and weighted-average recovery rate (WARR) levels when modelling the transaction cash flows.

Figure 3

Fitch Default Model Output (Dynamic Pool – Post Pre-Funding)

Rating level (%)	WAFF[a]	WARR[b]	MVD[c]
AAA	20.6	48.5	61.2
AA	16.7	54.0	57.2
A	12.9	59.5	53.2
BBB	9.0	65.1	49.2

Recovery time (years): Interest accrued on contractual rate for three years at 'AAA'
Recovery cost: 2.5% plus GBP3,000 fixed cost
[a] Weighted-average foreclosure frequency
[b] Weighted-average recovery rate
[c] Market value decline
Source: Fitch

Financial Structure and Cash Flow Modelling

Credit Enhancement

Subordination

The class B, C and D notes are sized at 5.25%, 5.00% and 2.25% of the mortgage portfolio respectively, and provide credit enhancement to the class A note. Any principal losses resulting from the mortgage portfolio will be recorded on the PDL which will be paid in such a way that the amount corresponding to the Class A notes will be paid first before the amount corresponding to the class B, C and D notes.

Reserve Fund

To provide limited coverage for any interest shortfalls and principal losses, the issuer has established at closing, a non-amortising fully funded reserve fund to the amount of 3% of the initial total collateral balance. This can step up to 4% of the initial total collateral balance if 60+ days arrears exceed 3% of the outstanding note balance or cumulative losses exceed 2%.

The monies held in the reserve fund will not be held in a guaranteed interest contract (GIC) account but will instead be invested in eligible investments, as Paragon believes it will be able to earn a higher rate of return. Fitch has however assumed a sub-Libor rate of return for the purposes of its cash-flow analysis (which is typically the case for a GIC account).

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.

To the extent available, excess spread, after meeting other senior expenses and interest on the class A note tranche, will be available to replenish any debit balances that arise on the PDLs. In addition, the excess spread can be used to pay down the class A, B and C notes after three years.

Principal to Pay Interest

If there is a shortfall in revenue funds to pay senior fees and interest on the class A, B and C notes, funds may be reallocated from principal receipts to cover the shortfall. The principal made available to cover these revenue deficits will be recorded on the PDL and is to be recouped from future revenue.

In its cash flow analysis, Fitch has modelled the principal draw mechanism, which is standard among UK RMBS pass-through transactions.

Liquidity Ledger

PM17 benefits from a liquidity ledger within the reserve fund, sized at 3% of the outstanding balance of the class A, B and C notes. This is to be used to cover senior expenses and interest on the class A notes. The liquidity ledger can also be used to cover interest on class B and C notes, subject to the PDL not exceeding 50% of the relevant class balance.

Minimum Mortgage Rate

The administrator must ensure that the WA margin applicable to the mortgages after taking into account all hedging arrangements, income received from the investment of funds in the transaction account, income from early repayment charges and scheduled releases from the margin reserve fund, is not less than three-month sterling Libor plus 4% until October 2017 and three-month sterling Libor plus 4.5% thereafter. Should the WA margin fall below these levels, the mortgage administrator will be obliged to either:

- increase the rates on variable-rate loans in the pool, to ensure sufficient revenue funds are available; or
- make a drawing on the subordinated loan, such that the required levels are met.

Margin Reserve Fund

A margin reserve fund, fully funded at closing, has been established to bring the interest payments on the loans to Libor plus 3.75% for the entirety of the teaser period. The funds will be released into the revenue waterfall according to a pre-determined schedule.

Early Amortisation Events: Events of Default

The following will constitute an event of default (EoD):

1. non-payment by the issuer of principal in respect of the notes within seven days following the due date;
2. non-payment by the Issuer of any interest amount on the notes within 15 days following the due date;
3. breach of contractual obligations by the Issuer under the relevant documents which is materially prejudicial to the interests of the holders of the most senior class of notes; or
4. an issuer insolvency event which is materially prejudicial to the interests of the holders of the most senior class of notes.

Scenario Testing

The capital structure has been stressed in Fitch's rating analysis under certain scenarios, including: high and low CPR scenarios; increasing and decreasing interest-rate scenarios; front and back loaded default curve scenarios.

The stressed scenarios result in no principal losses and the timely payment of interest for each note under each rating category. The most stressful scenarios in the cash flow stress tests are those with a decreasing interest rate, high prepayment, front-loaded default curve.

Counterparty Risk

Fitch performed an on-site operational review of Paragon to assess, among other things, the lender's origination, underwriting and servicing capabilities (see *Appendix B*).

Review visits do not constitute 'due diligence' and Fitch does not perform due diligence but relies upon the accuracy of data given to it.

Servicer

Moorgate Asset Administration (Moorgate – a wholly owned subsidiary of Paragon) has delegated its responsibilities to Paragon Finance (PFPLC) which is responsible for administering the mortgage loans in the Paragon-originated portion of the portfolio.

At the group's West Midlands headquarters, 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. Homeloan Management Ltd (HML) has been designated as substitute administrator.

Hedge Provider

Interest Rate Swap

At closing, the issuer will enter into a series of interest rate swaps to eliminate the risk between the fixed rate mortgages and note Libor. This hedging is based on a scheduled step-down balance. The counterparty for the interest-rate swap is Macquarie Bank Limited, rated 'A'/Stable/'F1', which satisfies Fitch's expected minimum rating for swap counterparties (detailed in the report entitled *Counterparty Criteria for Structured Finance Transactions: Derivative Addendum*, published 14 March 2011).

Upon a downgrade of Macquarie Bank Limited below Long-Term 'A' or 'F1', one of the following remedial measures must be applied by the swap counterparty:

1. arrangement for a third-party guarantor with the requisite rating;
2. transfer of the swap to a counterparty with the requisite rating; or
3. posting of the required collateral to cover the potential loss upon its default.

Only actions (1) and (2) are available upon a downgrade below investment grade. Where collateral is a feasible mitigant — for example, where the swap provider is rated at least investment grade — posting is expected to be effected within 14 calendar days upon the downgrade of the counterparty below 'A' or 'F1'. Where collateral cannot be used as a mitigant, remedial action is expected to be taken within 30 calendar days upon the downgrade of the counterparty.

Commingling Risk

Collections Account and Account Bank

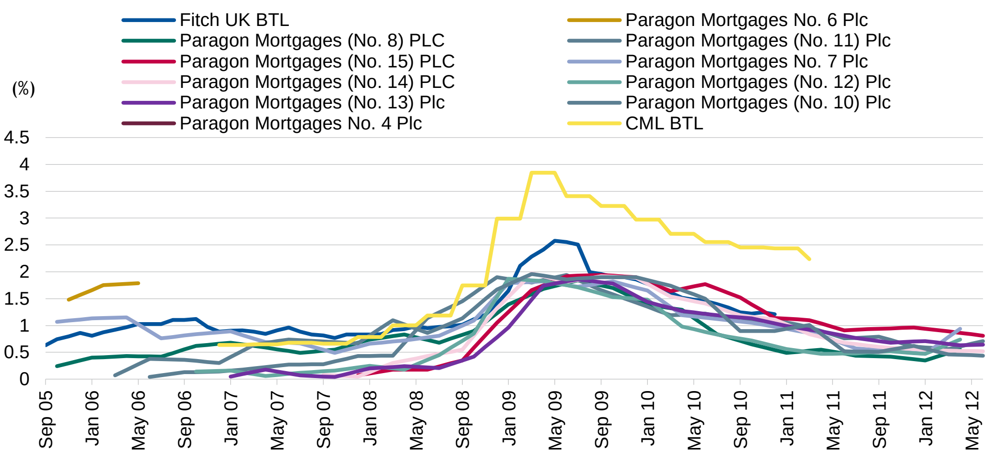
Mortgage payments are transferred from the servicer's collection account to the transaction account (both with National Westminster Bank plc (NatWest, 'A'/Stable/'F1')) within one business day. To mitigate any commingling risk, there is a back-up servicer (HML) in place on day one. Additionally principal and the reserve fund portion which is not part of the liquidity ledger may be used to cover for any class A, B and C note interest shortfalls and if that is not enough, the liquidity ledger sized at 3% of the class A, B and C notes may be used to cover for the class A note interest shortfalls. The liquidity ledger can also be used to cover interest on class B and C notes, subject to the PDL not exceeding 50% of the relevant class balance.

Performance Analytics

The performance of transactions in the Paragon series remains comparable to one another, with each of the transactions performing well, and better than the majority of other UK BTL transactions. As of April 2012, the volume of loans in arrears by three months or more ranged between 0.34% (Paragon 8) and 0.99% (Paragon 9) of their respective outstanding collateral balances. Paragon's extensive use of receiver of rent policies has contributed towards the relatively low level of arrears seen across the series. Additionally, cumulative losses to date range between 0.22% (Paragon 13) and 0.54% (Paragon 7).

Figure 4

Date-Based 3M + Arrears



Source: Fitch, Investor Reports

Related Research

Figure 5
Publication[a]

General rating and structured finance criteria	
Global Structured Finance Rating Criteria	6 June 2012
Criteria for Special-Purpose Vehicles in Structured Finance Transactions	30 May 2012
Counterparty risk criteria	
Counterparty Criteria for Structured Finance Transactions	30 May 2012
Counterparty Criteria for Structured Finance Transactions: Derivative Addendum	30 May 2012
Issuer's currency swap obligations rating criteria	
Criteria for Rating Currency Swap Obligations of an SPV in Structured Finance Transactions	8 August 2012
Interest-rate criteria	
Criteria for Interest Rate Stresses in Structured Finance Transactions	20 March 2012
Fitch's Interest Rate Stress Assumptions for Structured Finance	20 March 2012
Mortgage insurance criteria	
Global Criteria for Lenders' Mortgage Insurance in RMBS	3 August 2012
Country-specific criteria	
EMEA Criteria Addendum - United Kingdom - Mortgage Loss and Cash Flow Assumptions	9 August 2012
EMEA Residential Mortgage Loss Criteria	7 June 2012
Country-specific market studies	
Frequently Asked Questions in UK RMBS Master Trusts	31 January 2012
Surveillance	
EMEA RMBS Issuer Report Grades	14 November 2011

All the above research is available at www.fitchratings.com
[a] Criteria can be updated or amended: Readers should always make reference to the latest criteria available at www.fitchratings.com
Source: Fitch

Appendix A

Figure 6

Transaction Comparison

	PM17[d]	PM16	PM15
Closing date	**TBD**	**November 2011**	**July 2007**
Total issuance (GBP)	**TBD**	**163,800,000**	**1,000,000,000**
Preliminary Credit Enhancement %			
AAA	15.50	22.6	16.9
AA	10.25	n.a.	9.4
A	5.25	n.a.	1.9
BBB			
Initial reserve (% of initial balance)	3.0	3.0	1.9
	4.0	4.0	2.4
Liquidity	yes	yes	yes
WAFF (%)			
AAA	20.4	20.8	25.8
AA	16.6	17.0	20.7
A	12.7	13.2	15.5
BBB	8.9	9.4	10.3
WALS (%)			
AAA	68.0	57.7	44.8
AA	62.4	51.9	36.1
A	54.2	44.9	29.6
BBB	48.5	39.2	21.8
WARR (%)			
AAA	49.6	50.7	62.8
AA	55.2	56.4	71.5
A	60.9	62.2	78.1
BBB	66.6	67.9	85.8
WAMVD (%)			
AAA	61.2	59.7	46.6
AA	57.2	55.5	39.3
A	53.2	51.3	33.7
BBB	49.2	47.1	26.9
Portfolio			
Collateral balance (GBP)	140,249,017	128,928,887	677,142,700[c]
Average current balance per borrower (GBP)	243,066	217,052	146,599
WA original valuation (GBP)[a]	256,076	236,287	189,563
Largest indexed valuation (GBP)	2,637,073	2,000,000	3,900,000
WA seasoning (months)[a]	19	19	1.3
L/OM/SE concentration (%)[a]	49.1	56.6	50.7
WA OLTV (%)[a]	69.2	69.8	79.3
WACLTV (%)[a]	69.0	70.0	79.3
WACLTV (indexed values) (%)[a]	68.9	70.4	79.1
WAOLTV>80% (%)[a]	0.3	0.2	59.2
WAOLTV>90% (%)[a]	0.0	0.0	2.4
WA ICR (%)[b]	86.6	94.3	96.0
WA stabilised margin (%)	4.6	3.9	1.9
Interest-only loans (%)	93.9	90.4	96.0
Buy-to-let (%)	100.0	100.0	100.0

[a] As calculated by Fitch
[b] As calculated by Paragon using Fitch's interest rate assumption of 5.5% plus the relevant margin
[c] Max drawable collateral balance
[d] Provisional pool characteristics as of 30 September 2012

Appendix B: Origination, Underwriting and Servicing

Origination

Paragon Mortgages Limited (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 BTL products through intermediaries and since February 2001, the vast majority of originations have been to professional borrowers. Since September 2010, a new originator, Paragon Mortgages (2010) Limited has targeted the professional landlord market. To qualify for the benefits of such a loan a borrower must already possess a portfolio of at least three properties and must present a minimum of two years 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, the rental income from single, self-contained properties must be a minimum of 125% of the mortgage payment calculated on an interest only basis, at either the product rate, or a reference rate of 5%, whichever is the higher. The rental income for all other property types must be a minimum rental income of 130% of the mortgage payment calculated on an interest only basis, at either the product rate, or the reference rate of 7%, whichever is the higher.

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, ie in excess of GBP2m, 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 BTL lenders, PML prefers to retain manual discretion in its lending procedures rather than adhere to a pro forma approach. As such, a hierarchy of mandates adhering to guidelines and criteria is in place to ensure that accountability is maintained. At the heart of policy-making is the overarching credit committee - comprising four standing members and other experts, that are called upon as appropriate, - which convenes on a monthly basis and presides over any changes to criteria and special cases.

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.

Underwriting

PML has its own dedicated underwriting team where the underwriters are usually recruited from within the business, and 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 undertaken 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 however a successful switch to SIRA (Syndicated Intelligence for Risk Avoidance) occurred during 2006 and is still in place today. Since its re-entry into the buy to let market in 2010, Paragon has introduced a fraud policy to ensure both fraud prevention controls and compliance with regulatory requirements is in place.

Property Valuation

The Paragon Group has 18 regionally based staff surveyors who complete the majority of valuations; the remainder 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 Paragon staff surveyor.

Servicing

Moorgate has been appointed to act as the Administrator who will subcontract its duties to Paragon Finance PLC (PFPLC). PFPLC is responsible for administering the mortgage loans in the PML-originated portion of the portfolio. It invested in sophisticated collections technology following adverse credit experience suffered by the group in the early 1990s. At the group’s West Midlands headquarters, 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.

PFPLC is not a Fitch-rated servicer of residential mortgage loans. For more information on Fitch’s servicer rating programme see the reports titled *Global Rating Criteria for Structured Finance Servicers*, dated 30 September 2009 and *Rating Criteria for European Residential and Commercial Mortgage Loan Servicers – UK Market Addendum*, dated 28 January 2008.

Early Arrears Management

The servicing team currently manages the PML portfolios. Collectors will not see the loan unless it fails a direct debit payment. When that happens for the first time, a telephone call will be made to the borrower within 24 hours to attempt to rectify the situation.

Serious Arrears Management

If the borrower is two months in arrears, Paragon will appoint a Receiver Of Rent (property agent) on the entire portfolio of the borrower. No court approval is required for this. Paragon will send a surveyor with a property agent to the property and inform the tenant that they have to send their rent to the ROR, who forwards it on to Paragon, instead of paying the landlord. No monies from that point onwards are allowed to be passed on to the borrower. Payments received in excess of monthly mortgage payment are used to prepay the loans. A locksmith will also change the locks to the property where the property is not tenanted and a decision will be made to either rent or sell the property.

Even if the borrower becomes current at a later date, Paragon will not usually release the receiver of rent, which effectively forces a borrower to redeem all the mortgages with PML.

Foreclosure, Repossession and Sale

Once receiver of rent is appointed, the property cannot be sold if a tenancy is in effect unless it is in the best interests of the debt. At the end of the tenancy, Paragon could theoretically extend the tenancy if it chose to, but usually they would obtain vacant possession and sell the property.

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 is the standby administrator.

Appendix C: Transaction Overview

Paragon Mortgages (No.17) PLC — UK/Prime RMBS

Figure 7
Capital Structure

Class	Rating	Size (%)	Size (GBPm)	CE (%)	Interest rate	PMT freq	Maturity	Margin (%)
A	AAAsf	TBD	TBD	15.50	3-month Libor	Quarterly	April 2040	TBD
B	AAsf	TBD	TBD	10.25	3-month Libor	Quarterly	April 2040	TBD
C	Asf	TBD	TBD	5.25	3-month Libor	Quarterly	April 2040	TBD
D	NR	TBD	TBD	3.00	n.a.	Quarterly	April 2040	TBD

Reserve fund	3%
Liquidity ledger	3% of class A, B and C
First interest payment date	8 Jan 2013
Issuer call date	8 Jan 2016

Source: Transaction documents

Key Information

Closing date	TBD	**Parties**	Paragon Mortgages Limited and Mortgages Trust Limited and Mortgage Trust Limited
Country of assets	UK	**Seller/originator**	Paragon Finance PLC
Country of SPV	UK	**Servicer**	Moorgate Asset Administration Limited
Structure	Sequential	**Arranger**	Macquarie Bank Limited, London Branch
Settlement		**Joint lead managers**	Lloyds Bank Corporate Markets, Macquarie Bank Limited, Morgan Stanley (London Branch)
Listing	London Stock Exchange	**Principal paying agent**	Citibank, N.A., London Branch
Analysts	Usman Lakhani	**Cash collection account provider**	National Westminster Bank plc
	Simon Allsop	**Swap counterparty**	Macquarie Bank Limited

Source: Transaction documents

Summary

Rating Drivers

- **Buy-to-Let Poses Arrears Risk:** The portfolio consists entirely of BTL loans. Fitch continues to stress the portfolio's default rates beyond those for a prime owner-occupier portfolio at all rating levels, despite the historically lower arrears of past Paragon deals compared to many prime portfolios.
- **Non-Orphan SPV:** PM17 is 100% owned by The Paragon Group of Companies PLC (PGPLC). Since the issuer in this case is not an orphan vehicle, it is possible that under certain circumstances the issuer can become liable under UK tax laws for the tax liabilities of other entities in PGPLC. Fitch believes the risk of such a liability being assessed against PM17 is limited.
- **Pre-Funding Period:** Prior to the second principal determination date on 28 March 2013, roughly GBP56.0m of additional loans will be added to the pool. Any balance remaining to the credit of the pre-funding ledger after this period, not used to purchase additional loans, will be used to pay down the notes sequentially.
- **Sequential Structure:** The class A, B and C notes benefit from a sequential structure. Interest to the class D bonds are subordinated to the class A, B and C interest PDL and the reserve fund, increasing the excess spread available to cover for losses related to the class A notes.
- **Minimum Mortgage Rate:** The administrator must ensure a minimum mortgage rate (including inflow from hedges, other income and the margin reserve fund). Fitch has given no credit to this feature in its cash flow analysis.

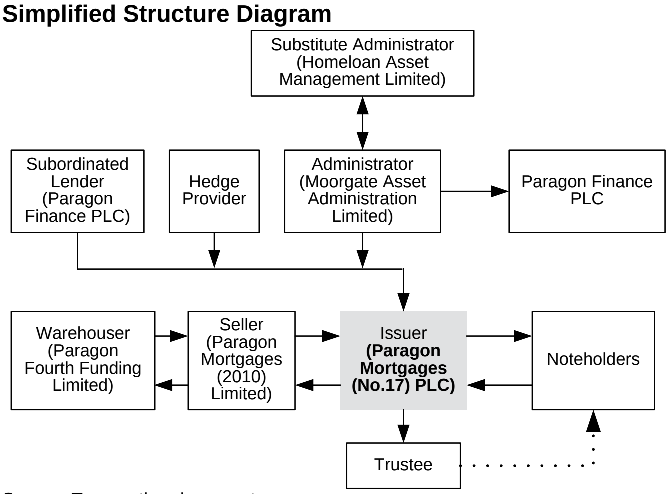
Source: Transaction documents provided by Paragon

Fitch Default Model Output (Static pool)

Rating level	AAA	AA	A	BBB
WAFF (%)	20.4	16.6	12.7	8.9
WARR (%)	49.6	55.2	60.9	66.6
Loss severity (%)	68.0	62.4	54.2	48.5
MVD	61.2	57.2	53.2	49.2

Source: Transaction documents

Simplified Structure Diagram



Source: Transaction documents

Collateral Summary

Provisional pool characteristics (as of 30 September 2012)

Original principal balance (ISO)	140,249,017	**Regional concentration (%)**	
Current principal balance (ISO)	140,754,583	London, SE & OM	49.1
Average current loan per borrower (ISO)	243,066	South West	8.8
Number of borrowers	577	North West	13.4
Number of loans	824	West Midlands	5.1
Seasoning (years)	2		
Loan to value (LTV) (%)			
WA OLTV	69.2	**Loans in principal grace period (%)**	
WA CLTV	69.0	Lien position:	
		First ranking	100.0
Mortgage characteristics		Jumbo (%)	37.7
WA ICR[a]	86.6	**Payments**	
Buy to Let (%)	100.0	Payment frequency	Monthly
		Payment method	Direct debit
Interest rate type		Performing loans (%)	100.0
Floating rate loans (%)	74.3		
Fixed rate loans (%)	25.7	Employment status (% of self-employed)	73.6

[a] As calculated by Paragon using Fitch's interest rate assumption of 5.5% plus the relevant margin
Source: Pool Data provided by Paragon

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.