

paragon

Financial results
Year ended 30 September 2010

The Paragon Group of Companies PLC



Agenda

paragon

Section 1	Financial results
Section 2	Strategy
Section 3	Private rented sector overview

paragon

Section 1

Financial results
Year ended 30 September 2010

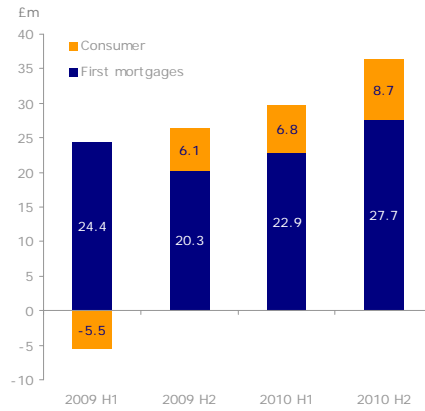


Financial highlights

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	2009 £m	2010 £m	% change
Pre-tax profit	54.3	71.8	32.2%
Of which:			
Exceptionals	12.4	5.7	
Fair value	(3.4)	0.0	
Operating profit	45.3	66.1	45.9%
Tax rate	24.3%	24.9%	
Dividend per share	3.3p	3.6p	9.1%
Basic earnings per share	13.9p	18.3p	31.7%
Shareholders funds per share @ 30 September	221p	234p	5.9%
Cost:income	26.1%	28.8%	

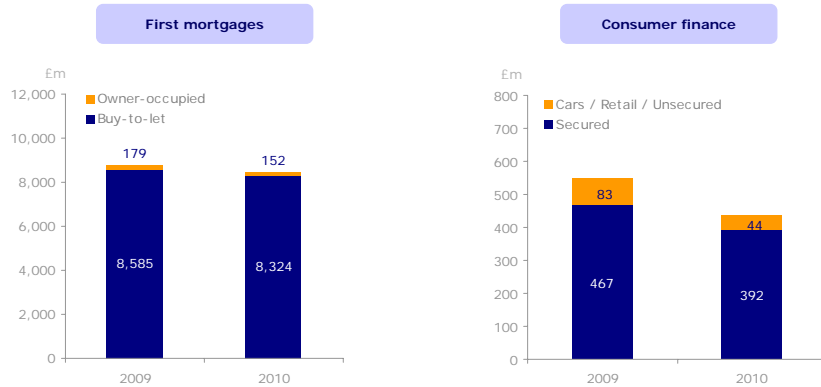
Segmental operating profit analysis



Underlying basis

4

Paragon segmental loan assets

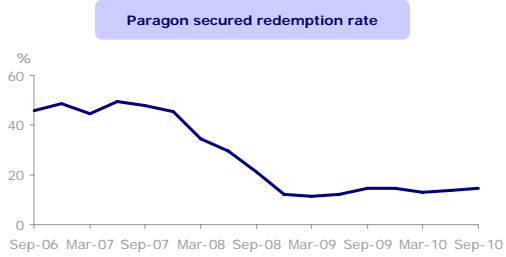
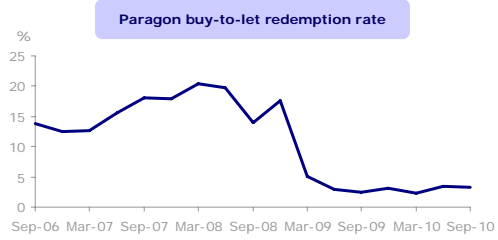


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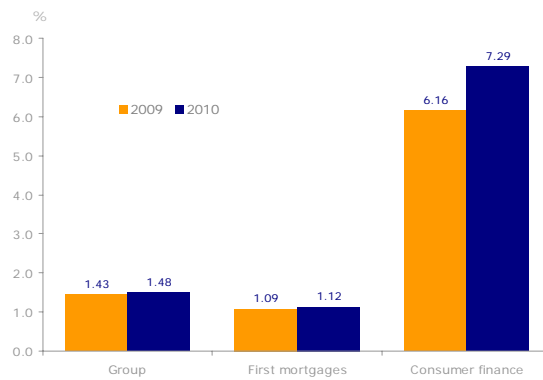
Segmental redemption rates



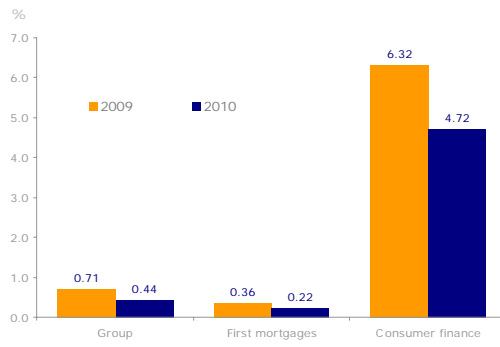
- Both buy-to-let and secured redemption rates remain stable at historically low levels
- Competitive product alternatives remain restricted
- Scheduled repayments are increasing on secured as it is a capital and interest product, reducing LTVs



Net interest margin

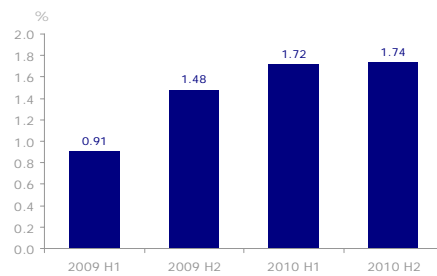


Impairment charge as % of total loan assets



Cash margins

• Free cash balances at 30 September:
£147.8m (2009: £84.0m)





Strategic objectives

New lending

- Pilot exercise in August/September
- Launch 28 September 2010
- Initial focus on managed distribution roll-out
 - Core commercial finance brokers
 - TBMC
 - Limited network range
- Product focus initially commercial professional landlords
- Criteria tight
- Encouraging application flows to date
- Application conversion cycle - 3 months

Strategic objectives

New lending

Warehouse facility

- £200 million mortgage warehouse facility provided by Macquarie
- Available to finance buy-to-let mortgages
- 4 year facility, 2 years revolving
- Fitch rated
- Structured on limited recourse basis
- Pricing – LIBOR + 2.875bp – securitisation execution expected to be more efficient

Strategic objectives

New
lending

Securitisation market

- RMBS market displayed significant improvement in 2010
- £58.1 billion primary issuance YTD (2009: £10.5 billion)
- Broader investor base
- Prime AAA spread stable at c LIBOR + 140bp
- Strong improvement in yields of subordinated tranches
- Paragon held c 100 bond investor meetings in 2010
- Securitisation viable source of funding

Strategic objectives

New
lending

- New lending economics remain favourable
 - Taking account of:
 - Current mortgage pricing (margin and fees)
 - Funding costs (warehouse/securitisation)
 - Costs (direct and pro-rata group reallocated)
 - Stressed bad debts (above historic experience)
 - Estimated securitisation credit enhancement / CRD minimum
- Post-tax ROE in excess of 15%

Buy-to-let market remains strong

New lending

- Social housing cuts in Comprehensive Spending Review will create more demand for private rented property
- Structural change in tenant demand set to continue
 - Population forecast to grow to 71.6 million by 2033 (2009: 61.8 million)
 - 252,000 new households per year – one person households account for 66% - greater propensity to rent
- Cyclical growth in tenant demand due to environment
 - Average age of FTB without financial support is 37 years
 - No sub-prime, self-cert market
 - Mortgage Market Review will reduce mortgage availability further
- Datamonitor mean forecast 2010 market BTL gross lending £10.6 billion



Source: Association of Residential Letting Agents / Office for National Statistics / Council of Mortgage Lenders / Communities & Local Government / Datamonitor

Customer retention

Strategic objectives

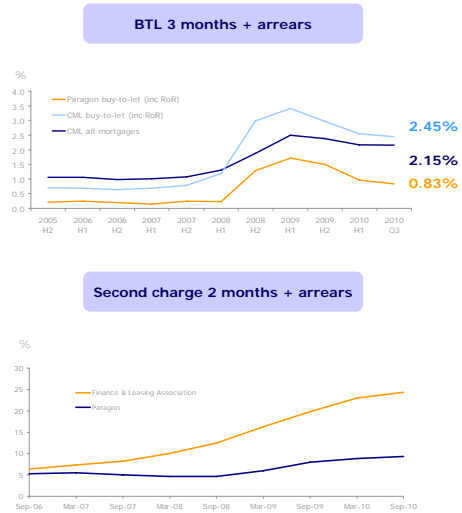
Optimise embedded value

- Buy-to-let redemption rates c 3% pa (historically c 20% pa)
- Product availability less than 10% of 2007 peak
- Paragon's terms highly competitive
- Landlords retain long-term investment horizon, rental margins strong
- Regulatory environment will increase capital requirements
- Fixed rate product switch opportunities offered to customers

Credit quality

Optimise embedded value

- Paragon buy-to-let and second charge arrears significantly outperform wider market
- 90% buy-to-let 3 months plus arrears subject to Receiver of Rent
- Second charge collections activity remains successful – 84% average monthly received v due



Source: Council of Mortgage Lenders / Finance & Leasing Association / Paragon

18

What if interest rates rise?

Optimise embedded value

- Interest rate outlook
 - Base rate at historic lows but will rise at some stage
 - However, likely to remain low for some time given extent of fiscal tightening and concerns over economic recovery
- Portfolio profile
 - Existing portfolio originated when 4.6% average base rate
 - Rental levels robust, evidenced by low arrears
 - Performing book ICR 3x covered
- Impact of interest rates on net assets
 - Paragon's capital invested in financial assets largely held in cash (total £536.7 million)
 - Return on this invested cash will rise as interest rates increase NII – c £7m pre-tax per 1%

19

Strategic objectives

Develop
new
income
sources

- Continued good progress
- New initiatives have contributed £4.9m to operating profit ahead of expected £3.5m
- 54% of accounts under management are third party
- Increased contribution expected for 2011

Strategic objectives

Develop
new
income
sources

- Existing purchased portfolios performing well
- £21 million consideration for BTL portfolio acquired at year end
- Opportunities likely to exist for several years
- Range of potential mortgage and consumer asset classes
- Portfolio purchase target IRR 15%+
- Significant portfolio purchase experience - past purchases total £3 billion
- Significant servicing experience across range of asset classes



- General regulatory environment continuing to deliver great uncertainty
- Basel III implications still unclear
- CRD rules to require 5% "skin-in-the-game" post 2011
- Buy-to-let unlikely to be regulated
- Consumer finance likely to switch from OFT to FSA, post-BoE restructuring
- Non-bank prudential supervision likely to increase

- Dividend policy progressive, c 10% per annum growth
- Capital available to support:
 - Working capital requirements
 - New lending programme
 - Acquisition of loan portfolios
 - capital recyclable to support new lending growth over time
 - Delivering a greater optimisation of capital, thereby enhancing ROE

- Excellent 2010 operating performance
- Return to new lending marks a watershed for the Group
- 2011 will see new lending develop further
- Outlook for PRS and BTL appears robust
- However, economic and market uncertainty will remain
- Portfolio purchase and servicing opportunities will continue for several years

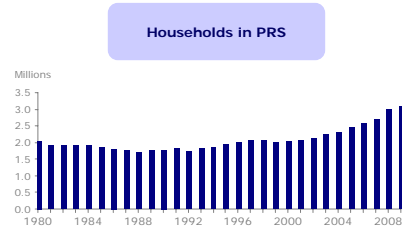
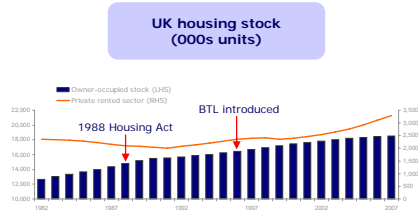
Section 3

Private rented sector overview



Overview of Private Rented Sector

- Prior to 1988 Housing Act, PRS in long-term decline
 - Act reformed landlord/tenant legislation
 - Strengthened landlords' confidence in property as an investment
- PRS grew throughout 1990s and 2000s, stimulated by:
 - Introduction of buy-to-let finance in 1996
 - Rising levels of tenant demand
 - Capital appreciation
- PRS expanded by 49% since 2001
- Conversely, owner-occupation and social housing are in decline
 - Owner-occupation accounts for 67.9% of households (2001: 70.4%)
 - Social housing fallen to 17.7% (1991: 23%)



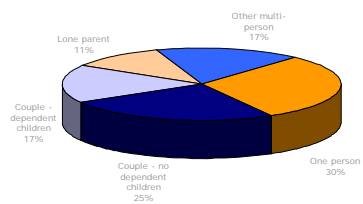
Source: Communities & Local Government

26

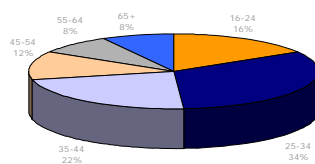
PRS – a vital contribution

- Provides a home for 3.2 million, or one-in-seven, households in England
- Houses a diverse range of demographic and social groups
- Makes an important economic contribution
 - CB Richard Ellis estimates PRS is worth £500 billion

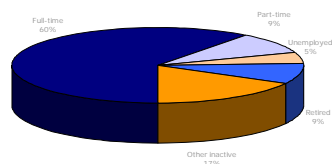
PRS household types



PRS household age



Economic status of PRS tenants



Source: Communities & Local Government

27

PRS – a growing role

Pressure on the PRS is set to grow due to short and long-term social, political and economic demographic factors

Government housing policy

- Social housing budget to be cut by 60% over next 4 years
- Social rents to be moved in line with private sector rents
 - Existing tenants will pay 50% of market rate
 - New tenants will pay 80% of market rate
- Social housing no longer a "home for life"
- Social housing waiting list stands at 1.8 million households in UK
- PRS will house greater number of social housing tenants
- Importance of PRS to UK housing needs will increase
- Active and competitive buy-to-let market essential to ensure supply keeps pace with demand

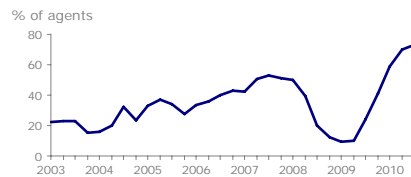
Limited house building

- 118,000 new home completions in 2009 – 51% below (240,000pa) target set by previous Government
 - Record low of 128,680 net dwellings last year
- "There is no doubt that the previous planning system was not succeeding in delivering enough homes – but housing delivery, crucial to solving the housing crisis, is not yet increasing and in many areas has actually fallen."
*Stewart Baseley, Executive Chairman
 The Home Builders Federation*
- NHPAU estimates up to 290,500 extra homes needed each year on average between 2008 and 2021
 - ONS expects population will grow to 65 million by 2016 and to 71.6 million by 2033 (2009: 61.8 million)
 - 252,000 new households in England forecast until 2031
 - One person households will account for two thirds of new households
 - Comprehensive Spending Review announced plans to build only 150,000 affordable homes over next 4 years

Balance of demand and supply

More tenants than properties

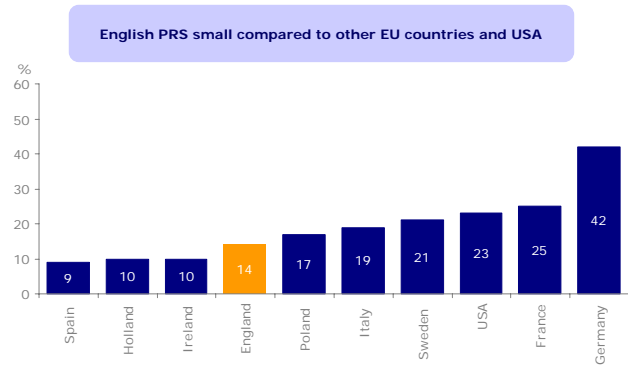
- Demand for private rented property surged
 - 73% of ARLA agents reported that there are more tenants than properties in Q3:10
 - Proportion of ARLA agents reporting an increase in achievable rent levels has risen sharply



Increase in rent levels

"The prospect of a severe rental housing shortage is ever more likely."
Ian Potter, ARLA Operations Manager





Sources: RICS European Housing Review / American Housing Survey

Buy-to-let

- Due to its commercial nature, buy-to-let is an unregulated product
- FSA proposed regulation of buy-to-let mortgages in 2009, however, unlikely to proceed

Landlords

- Currently governed by over 50 Acts of Parliament and 70 sets of regulations
- New Housing Minister, Grant Shapps, scrapped new regulation set to be introduced by previous Government
- Emphasis on utilising local authorities' existing powers

General mortgage market

- FSA proposed number of measures that could restrict future mortgage supply in Mortgage Market Review
- Severe restrictions on interest-only and self-certification mortgages going forward
- FSA, which currently regulates mortgage industry, to be abolished in 2012 and majority of powers transferred to Bank of England

Buy-to-let market

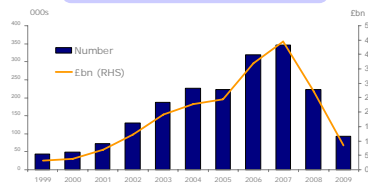


UK buy-to-let market

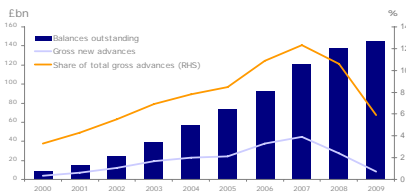


- Buy-to-let gross advances experienced rapid expansion between 2000 and 2007
- Credit crunch severely impacted sector
- 2009 lending by value and volume lowest since 2001
- Market stabilised throughout 2010
- Balances outstanding continued to grow throughout period

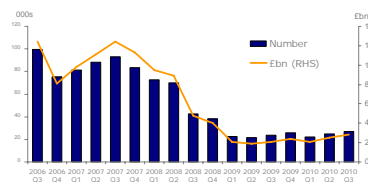
Annual BTL gross lending



UK BTL market



Quarterly BTL gross lending



Buy-to-let market – in recovery?

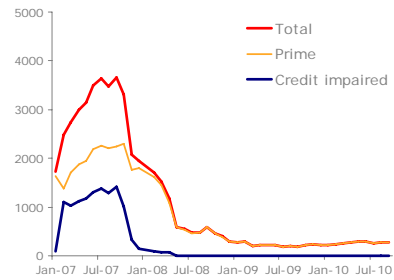
- Product availability declined by 92% since peak, but has recovered slightly in recent months
- Criteria has also eased
- Number of buy-to-let lenders increased by 20% to 54 lenders over last 12 months

"The buy-to-let market has taken a big hit in the last few years, but it is slowly starting to fight back. Lenders are returning to the market, bringing much needed competition back to the sector."

Michelle Slade, Moneyfacts, October 2010

LTV	Oct-2009 No/products	Oct-2010 No/products	Increase
60%	68	82	20.6%
65%	29	57	96.6%
75%	65	99	52.3%
80%	4	12	200.0%

Available BTL products



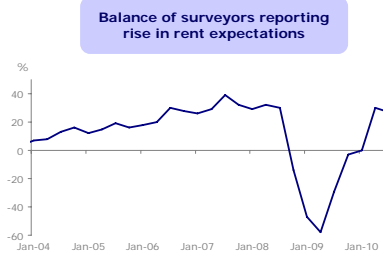
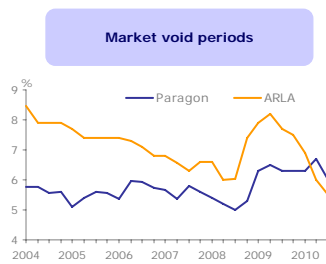
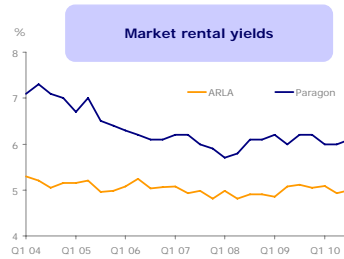
Buy-to-let – a professional's market?

Majority of lenders impose stifling aggregate lending limits

Lender	Max number of properties	Max aggregate loan value
The Mortgage Works (TMW) (Nationwide)	N/A	80% LTV to £1.5m 65% LTV to £5m
Lloyds Banking Group (BM Solutions, Woolwich, Halifax, Cheltenham & Gloucester)	3	£2m
Godiva (Coventry Building Society)	10 (3 within Group)	N/A
Platform (Co-Operative Bank)	3	£1m
Leeds Building Society	4	£1.25m
Northern Rock	10	£3m
Aldermore Mortgages	2	£1m
Post Office	5	£2m
Bank of China	10	£2m
Paragon	Unlimited	£5m

Attractive returns

- Yields (portfolio's rental income as a % of its value) are a key component of landlord returns
 - Yields steady throughout 2009 and 2010
 - Yields offer landlords consistent and sustainable income
- Rents have risen as tenant demand exceeds supply
- Voids reduce as tenants compete for available properties
- Proven credit quality – BTL arrears have been higher than wider mortgage market for only 3 quarters since 1998



Source: Association of Residential Letting Agents/Royal Institute of Chartered Surveyors

Landlords



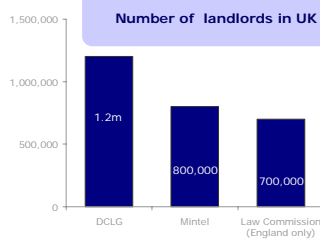
Who are UK landlords?

- Average landlord is:
 - Over 50 years old
 - Owns 7.8 properties
 - Intends to retain investment for 18 years

Length of time as landlord

Years as landlord	Individuals and couples	Companies	Other organisations	All landlords
5 or less	34%	9%	6%	27%
6-20	49%	37%	41%	46%
21-40	15%	27%	14%	17%
40+	3%	27%	39%	10%

Average length of time as landlord = 16 years



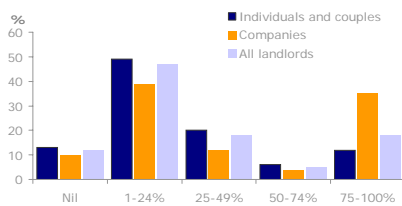
Source: DCLG Private Landlords Survey / Communities & Local Government / Association of Residential Letting Agents

Amateurs or professional?

- Majority of PRS stock is held by professional landlords
- CLG Private Landlords Survey shows that individual landlords typically derive up to a quarter of their income through rent
- Over two thirds of individuals and couples state that letting property is a secondary occupation

Extent of involvement	Individuals and couples	Companies	Other organisations	All landlords
Letting is main business	17%	56%	31%	25%
Let property with other property interests	12%	14%	18%	13%
Letting property is secondary occupation	71%	30%	51%	62%

Proportion of income derived from rent



PRS stock predominantly held by professional



Source: Communities and Local Government/Communities and Local Government Private landlords Survey

Landlords committed to property investment



Landlords are proven long-term holders of buy-to-let property

Latest ARLA survey shows positive mood amongst landlords with key data showing significant improvement

79% of ARLA landlords do not expect to sell their buy-to-let investments during the next 12 months

26% intend to acquire further buy-to-let investments during the next 12 months

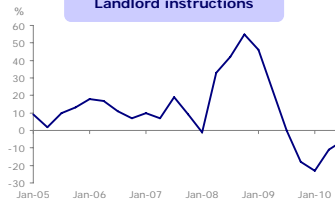
75% said the average life expectancy of their property investment is 10 years or more

Landlord sales



The proportion of landlords opting to sell their property has increased but remains low

Landlord instructions



Decline in would-be sellers letting property has revealed the impact of lack of BTL financing on new supply

Source: Association of Residential Lettings Agents/Royal Institute of Chartered Surveyors

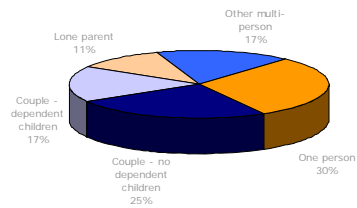
Tenants



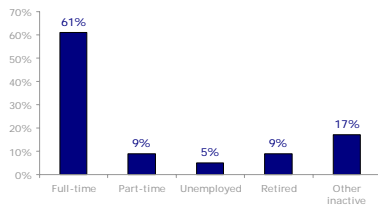
Tenant profile

- PRS provides a home for a wide range of people
 - 53% - couples or families
 - 30% - one person households
 - 17% - other multi-person households
- Age of tenants:
 - 16% - under 24 years
 - 56% - between 25-44 years
 - 28% - over 45 years
- 20% of private renters in England received housing benefit in 2007

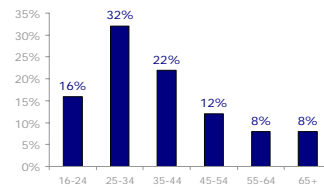
Household types in PRS



Economic status of PRS tenants



Age of PRS tenants

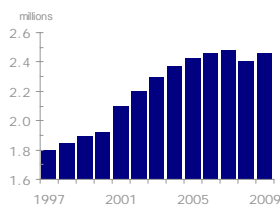


Source: CLG English Housing Survey 2008-09

42

Tenant demand

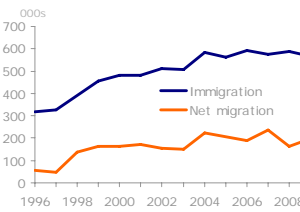
Strong growth in student population



Source: Higher Education Statistics Agency

Tenant demand continues to grow, underpinned by demographic trends and economic environment

Immigration levels remain high

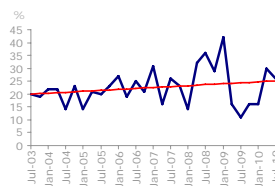


Source: Office for National Statistics

"It is clear that in a market where access to home ownership has become more difficult, the private rental sector is experiencing, and will continue to benefit from, high levels of demand for good quality housing."

CML Director General Michael Coogan, November 2010

Balance of surveyors reporting rise in tenant demand

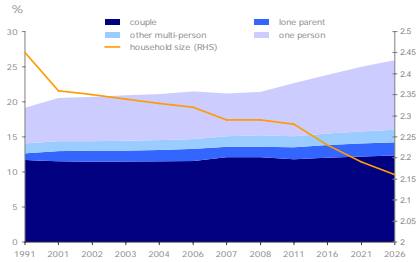


Source: RICS

43

Rise of one-person households

- Significant increase in one-person households
 - 1971: 18%
 - 2008: 30%
- Implications for ability to afford to purchase property
- One person households have higher propensity to rent
- Most common tenant type in the PRS
- One person households forecast to account for two thirds of future household formation



Source: Communities & Local Government

Decline of first-time buyers

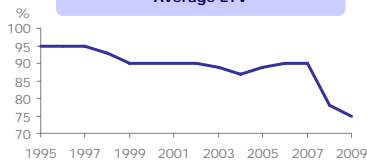
- Affordability constraints, lifestyle choices and rising student numbers are contributing
- First-time buyer (FTB) numbers in 2008 at a historic low, marginal increase in 2009
- Average age of unassisted FTB has risen from 33 before the credit crunch to 37 in 2009
- Average LTV for FTBs fell from 95% in 1994 to 76% in September 2010

First-time buyers as % of all buyers



First-time buyers as a proportion of all buyers has fallen from 55% in 1994 to 38% in 2009 - some recovery, but still historically low

Average LTV



First-time buyers under age of 25



19% of first-time buyers were under-25 in 2009, down from 30% in 1991

Source: Council of Mortgage Lenders / Communities and Local Government

First-time buyer affordability

- Market conditions are difficult for FTBs, with absence of high LTV products
- Lower LTVs have caused deposits to increase, despite falling house prices
- First-time buyers in 2008 were 46% down on 2007, slight increase in 2009 (2.3%)
- 80% of first-time buyers require financial assistance from family members to raise deposit

	Oct-07	Oct-10
Average house price	£186,044	£164,381
Average FTB LTV	90%	76%
Average deposit	£18,604	£39,451

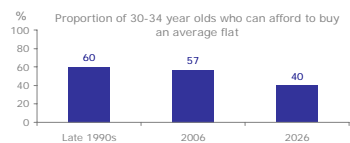
“Tighter lending criteria have clearly made it more difficult for first time buyers to enter the market.”

Michael Coogan, Council of Mortgage Lenders

Ownership aspirations

- 59% of private renters hope to eventually purchase their own property
 - Of these, 42% do not expect to buy for at least 5 years (35% in 2006/07)
 - Only 14% expect to be able to buy within the next 2 years (34% in 2006/07)
- Reflects decline in affordability and changes in loan availability

Declining affordability

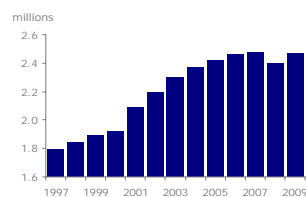


- Modelling by NHPAU shows that in late 1990s, 60% of 30-34 year olds could afford to buy average flat
- By 2006, proportion was 57%
- In 2026, only 40% are expected to be able to buy

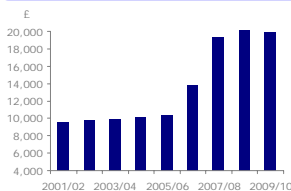
Rising student population and graduate debt

- Student fees set to rise – capped at £9,000 per annum from 2012 (current level: £3,290)
- Number of students in higher education up 30% over last decade
- University applications up 22.9% in 2009
- Universities only able to supply accommodation to 25% of students
- Average student debt owed to Student Loans Company on graduation up 96% in last 5 years to £19,920 (excludes loan interest, credit card debt, overdrafts etc)

Number of students in higher education



Debt owed by average graduate to SLC



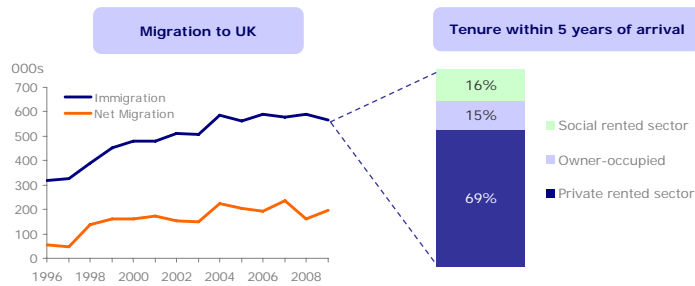
Inward migration

- In 2009, 567,000 people migrated into the UK, a small decline compared with 2008 (590,000)
- Net migration increased however as emigration fell
- Levels still exceed pre-EU enlargement
- Inward migrants have a greater propensity to rent

“Net migration has been a major contributor to the growth of the private rented sector in recent years but, unless it drops considerably further, the recession-driven drop in migration is unlikely to push residential rents down this year.”

Capital Economics, April 2010

Government forecast population to grow from 61.8 million to 71.6 million by 2033



Source: Office for National Statistics / Council of Mortgage Lenders / Communities and Local Government / ARLA

48

Conclusion



Outlook is positive



- Demand set to remain high and already outstripping availability of property
- Void periods likely to remain low given competition for properties
- Yields expected to improve
- Landlords remain committed to private rented sector
 - But funding new properties remains an issue
 - Potential for rental property supply shortage

50

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51