

# The Paragon Group of Companies PLC

## Results Presentation

Year ended 30 September 2007



### Agenda



Section 1	2007 financial results
Section 2	Current environment
Section 3	Funding
Section 4	Conclusion
Appendix A	Group overview
Appendix B	Buy-to-let investment case

## Section 1

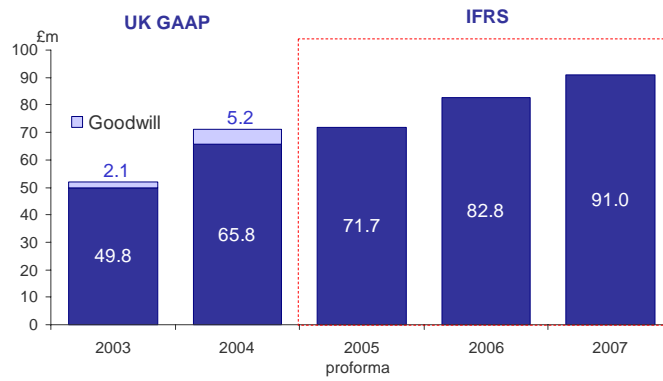
### Financial results

For the year ended 30 September 2007

### Financial highlights — year ended 30 September 2007

<b>Pre-tax profit</b>	<b>Fully taxed EPS</b>	<b>Total equity</b>
+ 9.9%	+ 11.8%	+ 12.3%
<b>£91.0m</b>	<b>57.7p</b>	<b>£313.3m</b>
<b>Cost:income ratio</b>	<b>Fully taxed ROE</b>	
<b>25.2%</b>	<b>21.5%</b>	

## Profit record

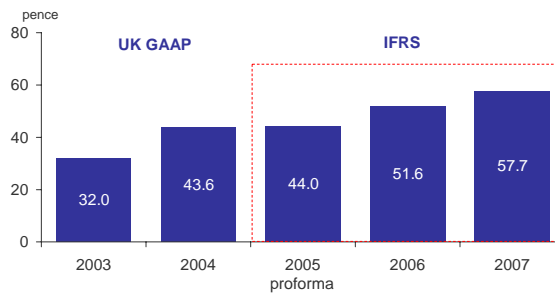


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## EPS increased



- Fully taxed EPS increased by 12%
- Effective tax rate: 31%



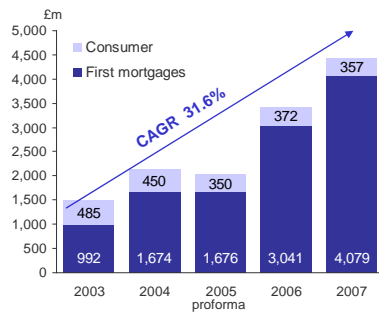
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## New lending and loan assets



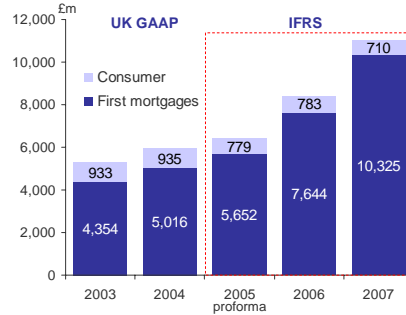
### New lending

- 30% growth in new lending
- Buy-to-let lending increased by 34%



### Loan assets

- Total loan assets 31% higher
- Buy-to-let assets increased by 39%

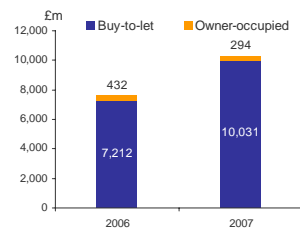


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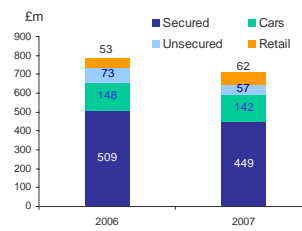
## Segmental loan assets and profit analysis



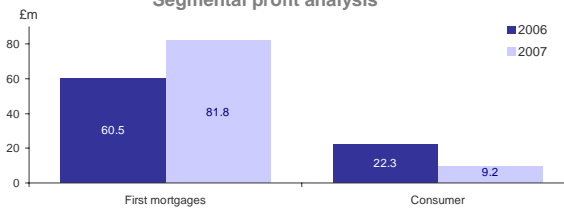
### First mortgages loan assets



### Consumer finance loan assets

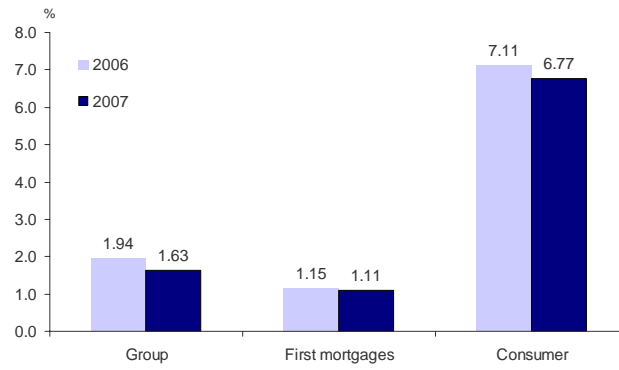


### Segmental profit analysis



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## Net interest margin

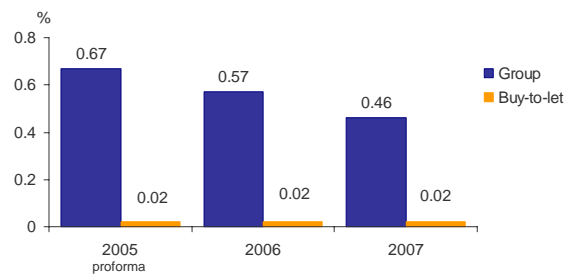


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## Bad debt charge as % of loan assets



Low and reducing impairment charge for continuing operations

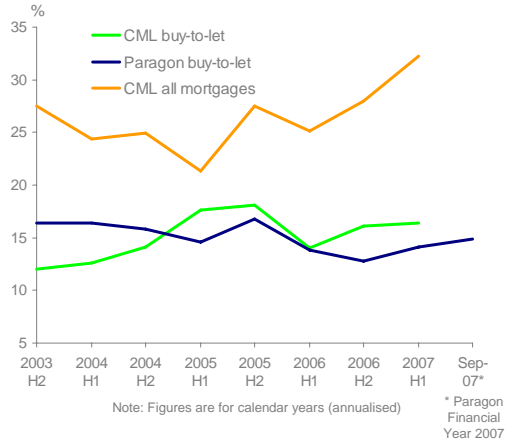


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## Redemption rates

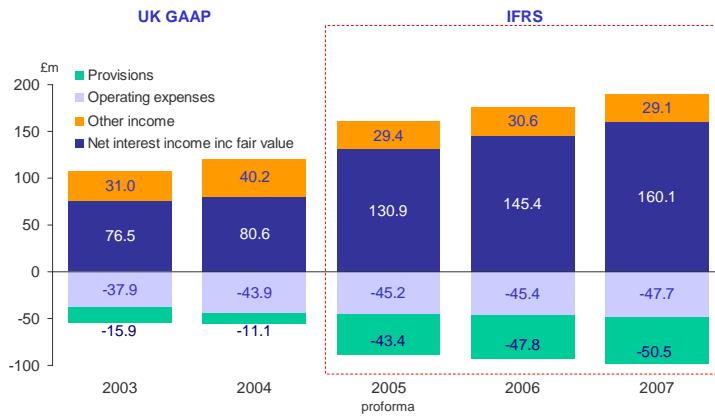


- ✦ Average investment hold period 16 years
- ✦ Lower housing transactions
- ✦ Retention rates high with strong repeat business levels
- ✦ Enhanced embedded lifetime customer value
- ✦ Closer customer relationship opportunities
- ✦ Buy-to-let is pension substitute



Source: Paragon / Council of Mortgage Lenders

## Operating profits



## Section 2

### Current environment

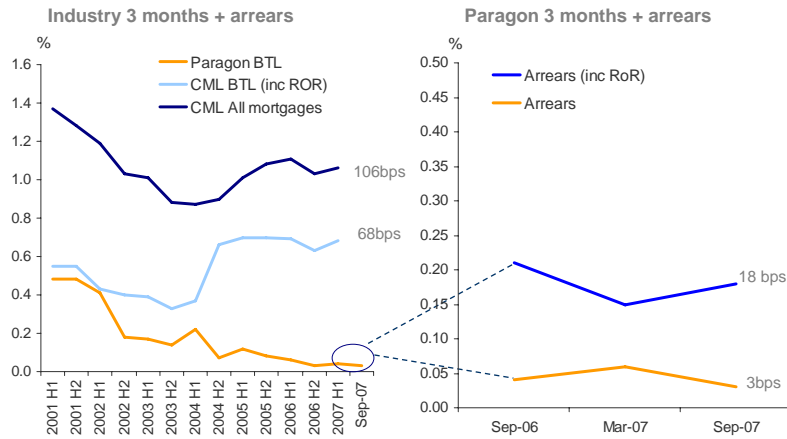
### Market issues

- August – credit crunch
- September – Northern Rock
- October/November – further deterioration in markets
- Capital markets healthier than banking markets
- Compounded by year end issues
- Cost of debt risen across the board, largely being passed on to customers

- Virtual curtailment of new issuance since August
- Current lack of differentiation between asset quality and structures
- Bank RMBS investors impacted by capital constraints especially around year-end
- Some private placement activity, early indications of demand
- B&B pricing – AAA LIBOR + 44-53 bps
- Realistically no new issuance until at least Q1:08

- Whilst 2008 will see a slower housing market:
  - Landlords experiencing record rental growth (RICS)
  - Tenant demand continues to outstrip supply (ARLA)
  - Lower levels of activity in general housing market will boost demand for rental supply
  - Continued growth in UK households – migration, students, etc
  - Some landlords will see this as a buying opportunity
  - Although likely others will defer investment decisions due to uncertainty
  - Unlikely that landlords will bail out when there is strong tenant demand
- Fundamentally, long-term growth prospects for BTL remain sound
- High credit quality

## Buy-to-let arrears analysis



Source: Council of Mortgage Lenders / Paragon

(Note: Figures are for calendar years)

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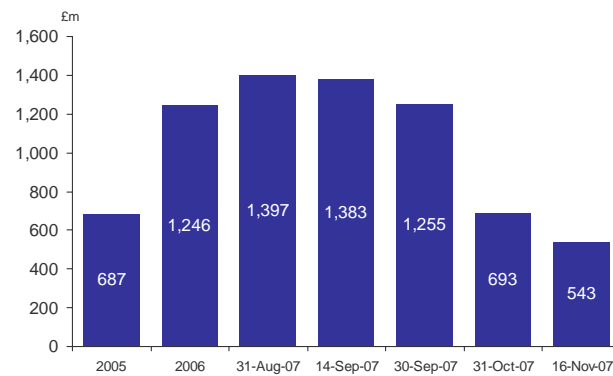
## Buy-to-let strategy



- Current strategy driven by funding capacity and pricing
- Manage new business volumes at lower level:
  - Products re-priced to extend liquidity duration
  - Criteria tightened
- Volumes will remain low until clarity over market funding pricing and capacity

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## Pipeline managed down



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## Buy-to-let strategy



- Current strategy driven by funding capacity and pricing
- Manage new business volumes at lower level:
  - Products re-priced to extend liquidity duration
  - Criteria tightened
- Volumes will remain low until clarity over market funding pricing and capacity
- Cost control c10% headcount cut already
- Cost/activity management to remain a focus
- Protecting franchise with key broker relationships with future volume potential
- Third party forward flow agreements under discussion
- Establish funding arrangements to protect the business in the current environment

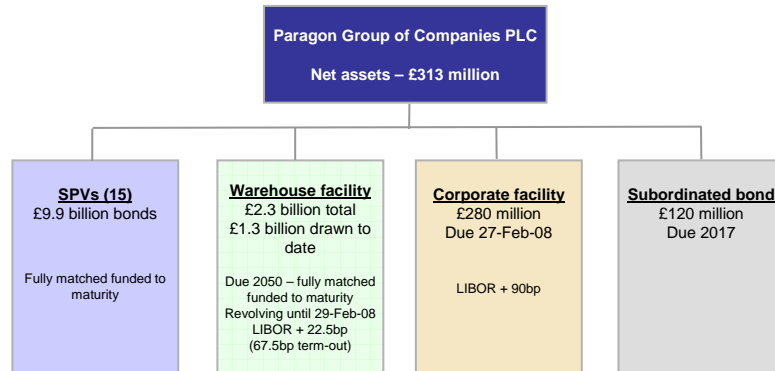
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- Market remains weak
- All consumer finance assets pre-funded with substitution capacity to lend more
- Tightened credit criteria
- No significant growth – in line with strategy

## Section 3

### Funding

## Group's funding structure



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## Bank facilities renegotiations



- Corporate and warehouse being renegotiated together
- Syndicates virtually identical
- Renegotiation affected by environment
- Extensive negotiations
- Terms available but unattractive
- Consequently standby rights issue put in place

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## Standby rights issue



- £280 million standby rights issue – until end February
- Underwritten by UBS
- Sub-underwritten by major shareholders
- Pricing to be established in due course
- Subject to normal terms and conditions
- Alternatives already under discussion to reduce size / requirement of rights issue
  - Restructure existing syndicates
  - Structured finance debt repackaging
  - Corporate debt
    - Senior
    - Subordinate
- Non-core assets (£80m) disposal programme
- Key objective to protect embedded value and provide platform to secure new sources of funding

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## Funding



- Assuming rights issue:
  - **99% debt maturity matched**
  - **Non-matched debt maturing – 2017**
- If not, financing on acceptable terms

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Represented by:

- Shareholder funds £313 million
- Embedded future profits in existing loan portfolios
  - 99% assets funded by mortgage-backed debt to maturities
  - Margins locked in at issuance
  - BTL margins stable, 99bp in 2006 and 101bp in 2007
  - c95% revenue driven by portfolio not activity
  - Key sensitivities:
    - Credit:
      - High quality assets
      - Buy-to-let 90 days+ arrears 18bp
      - Average LTV 66%
    - Loan duration:
      - Remains significantly below mainstream average
      - Fixed rate maturities mitigated by slower housing market
      - Retention activities
    - Costs:
      - Sector leading cost:income ratio already low
      - Broker costs totally variable
      - Alignment of cost base to reflect activity levels

## Section 4

## Conclusion

- Whole market affected by credit crunch
- Standby will provide platform to refinance and protect embedded value
- Our strategy:
  - Complete restructuring of funding
  - Manage reduced level of lending volumes
  - Ensure costs aligned to activity
  - Protect franchise
  - Provide basis to rebuild activity when credit markets permit
- Fundamentals of buy-to-let remain sound

## Appendix A

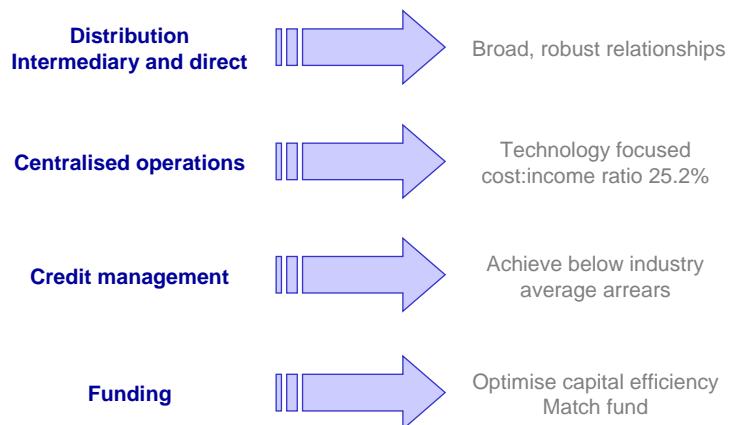
### Group overview

Paragon Group overview



Loan assets		Business mix	
First mortgages £10.3 billion	Consumer finance £0.7 billion	Loan portfolio 98% secured	New lending 96% secured
Funding		Securitisations	
£11 billion assets	Long-term matched funding	Most established UK securitisation issuer	53 transactions £19.5 billion

Paragon strategy



## Paragon buy-to-let strategy



Diverse strategy covers wider residential investment market



Professional/SME Complex product requirements	Experienced investor Pension substitute Medium sized portfolio	Private investor Limited experience Retail product offering
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←	Intermediaries Direct	94% 6%	→
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**Distribution**

Strong repeat business flow

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## Buy-to-let landlord profile



	Paragon Mortgages	Mortgage Trust
<b>Age:</b>	50 years	44 years
<b>Years as a landlord:</b>	13.5 years	9 years
<b>No of properties:</b>	11.5 properties	8 properties
<b>Average income:</b>	£79,400	£59,500
<b>Average value of portfolio:</b>	£1.47 million	£1.28 million
<b>Overall LTV ratio:</b>	38%	53%

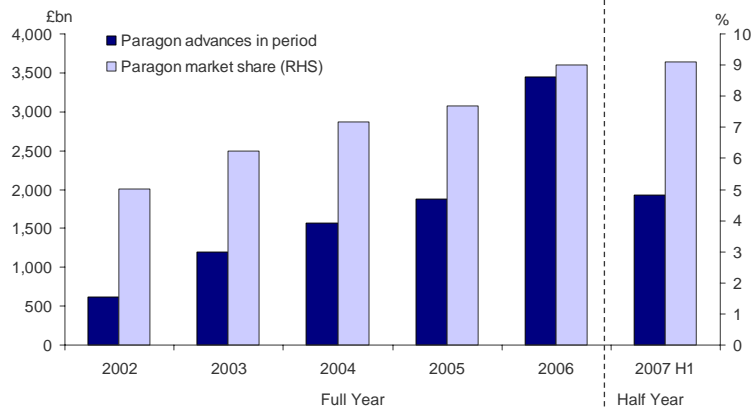
Source: Paragon survey

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## Paragon market share



Paragon market share has increased - latest figures for 2007 H1: 9.1% market share



Source: Council of Mortgage Lenders / Paragon

(Note: Figures are for calendar years)

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## PRS and buy-to-let market



- PRS 38% real growth over last 15 years
- PRS units grew by 10% in the last two years, during which time total housing stock grew by only 1.7%
- New lending in 2006 - £38.4 billion – 11% of all mortgages
  - 2007 H1 - £21.2 billion – 12% of all mortgages
- High socio-economic group customers
- £108 billion mortgage debt outstanding
- Excellent credit quality with longer average loan life
- Under-gearred sector

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## Top 10 buy-to-let lenders



H1 07	by Gross Advances	by Balances Outstanding
1	Mortgage Express (Bradford & Bingley)	Mortgage Express (Bradford & Bingley)
2	Birmingham Midshires (HBOS)	Birmingham Midshires (HBOS)
3	<b>Paragon Group</b>	<b>Paragon Group</b>
4	Northern Rock	Bristol & West
5	Cheltenham & Gloucester (Lloyds TSB)	Cheltenham & Gloucester (Lloyds TSB)
6	Mortgage Works (Nationwide)	Northern Rock
7	GMAC	Capital Home Loans (Irish Life & Permanent)
8	Bristol & West	Mortgage Works (Nationwide)
9	Capital Home Loans (Irish Life & Permanent)	Mortgage Business (HBOS)
10	Mortgage Business (HBOS)	Barclays - Woolwich

Source: Council of Mortgage Lenders

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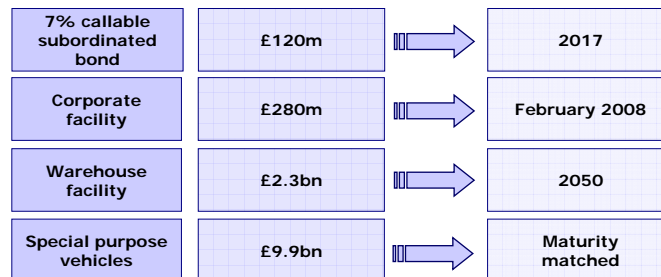
## Consumer finance strategy



Secured 2007	Point of Sale 2007
Loan book £449m New lending £206m	Loan book £204m New lending £151m
<ul style="list-style-type: none"> <li>All lending secured by mortgages on residential property</li> <li>PPF targets prime customers</li> </ul>	<ul style="list-style-type: none"> <li>Car finance:                             <ul style="list-style-type: none"> <li>Primarily new cars</li> <li>Origination via medium-sized dealers and brokers</li> </ul> </li> <li>Retail:                             <ul style="list-style-type: none"> <li>Originations via specialist retailers</li> <li>Product focus on furniture/floor covering</li> <li>Primarily sales aid initiatives</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>Sub-prime originations passed to Morgan Stanley for fee income – volumes negligible in current market</li> </ul>	

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## Securitisation and funding



### Funding activity 12 months to 30 September 2007

- October 2006 – PM13 - £1.5 billion (buy-to-let)
- January 2007 FF7 - £269 million (owner-occupied)
- March 2007 – PM14 - £1.5 billion (buy-to-let)
- July 2007 – PM15 - £1.0 billion (buy-to-let)

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## Shareholder structure



### Top ten shareholders (% of shares held at 31/10/07)

Holdings @ 31 October 2007	
1. Veer Palthe Voute	7.79%
2. BlackRock	7.03%
3. M&G Investment Management	6.89%
4. Standard Life	5.62%
5. The Paragon Group of Companies	5.51%
6. Scottish Widows	5.10%
7. Rathbone Investment Management	4.48%
8. Oppenheimer Capital	4.29%
9. Legal & General	4.24%
10. Schroder Investment Management	3.96%

- 100% free float
- Management interest 5%
- Corporate brokers:
  - ABN AMRO
  - UBS
- Analyst coverage:
  - ABN AMRO
  - Cazenove
  - Clear Capital
  - Credit Suisse
  - Daniel Stewart
  - Fox-Pitt Kelton
  - HSBC
  - KBC Peel Hunt
  - Keefe Bruyette & Woods
  - Numis
  - Oriel Securities
  - Landsbanki
  - Shore Capital
  - UBS

Source: UBS

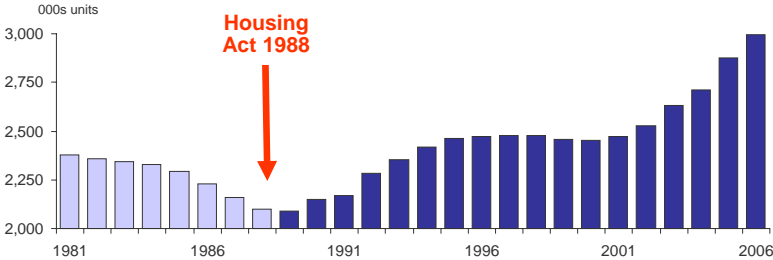
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### Appendix B

### Buy-to-let investment case

### Private rented sector

Prior to the Housing Act of 1988 the UK private rented sector had been in long-term decline

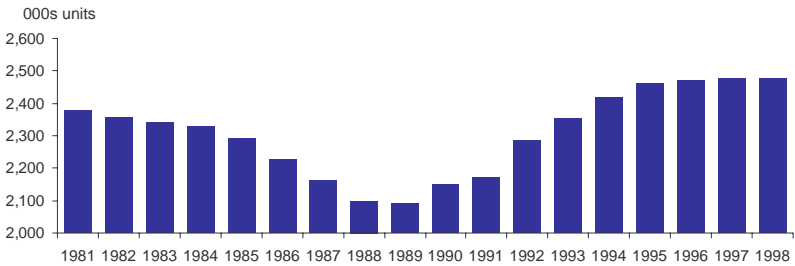


*“The modern private rented sector was founded at that time through a combination of changing government policy and social trends”*

Source: Communities and Local Government

Expansion in early 1990s...

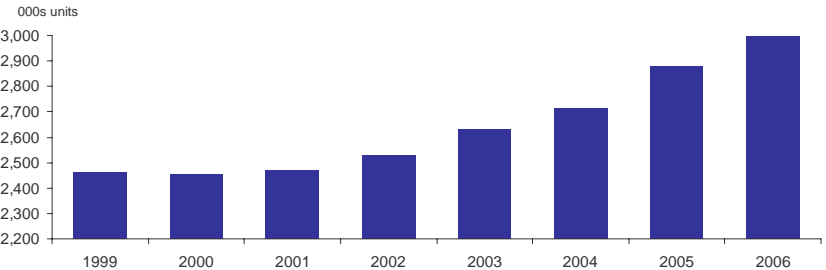
- First-time buyer confidence affected
- Private renting increased rapidly
- Strong tenant demand supported rental incomes
- Falling house prices combined with strong rental demand improved yields
- Professional landlords took advantage of purchase opportunities



Source: Communities and Local Government

...followed by further expansion in early 2000's

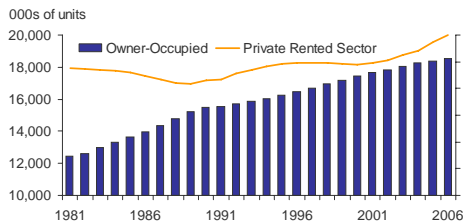
- Rapid house price inflation priced first-time buyers out of the market
- This led to a rapid increase in private renting
- Strong tenant demand supports rental incomes
- Professional landlords remain committed to the market



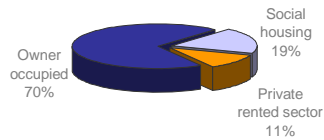
Source: Communities and Local Government

## Household trends and tenure of stock

- Between 1971-2006:
  - UK population increased by 8%
  - Number of households increased by 30%
- Growth in owner-occupation slowed in recent years; private rented sector growth increased
- PRS now accounts for 11% of UK housing stock
- 5-6% of all households currently live in BTL properties (ARLA)



Tenure of UK housing stock (26.4m properties):



Source: Communities and Local Government

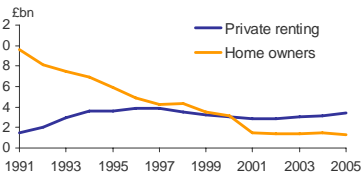
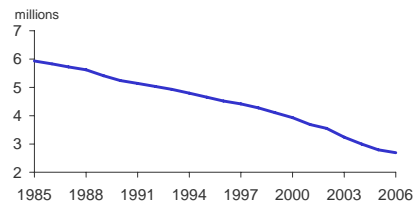
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## Government policy on private rented sector

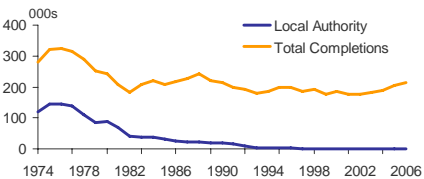
**“...The Government's objective is to secure a larger, better-quality, better-managed private rented sector”**

- Tenure neutral housing policies
- MIRAS removed from owner-occupation
- Stamp duty imposed
- Reform of landlord / tenant legislation – Housing Act 1988
- Tenancy Deposit Schemes
- Government help with housing costs for homeowners has fallen:

- There has been a persistent decline in dwelling stock rented from local authorities:



- Local authority housing completions remain low:

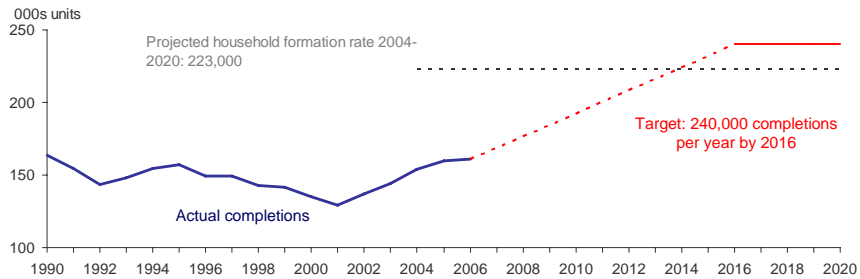


Source: Council of Mortgage Lenders / Communities and Local Government

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## Government housing policy: future plans

- July 2007 Green Paper on Housing in England:
  - aims to build 3m new homes by 2020, with completions rising to 240,000 per year by 2016
  - pledge to double annual rate of social housing completions
- However, demand back-log will continue to grow



***“ I also recognise you have got to combine the building of housing for ownership with the building of houses for rent in a far more mobile and fluid society”***

Gordon Brown, May 2007

Source: Communities and Local Government

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## Green Paper: supply of affordable housing in England

- Housing completions will need to increase sharply to meet the target of 240,000
  - 167,577 completions in 2006
- Affordable housing plans
  - aim to provide 25,000 shared-ownership homes each year
- Social housing
  - 1.6 million households on waiting list
  - demand increases by 40,000 per year
  - extra 45,000 units per year will make little impact

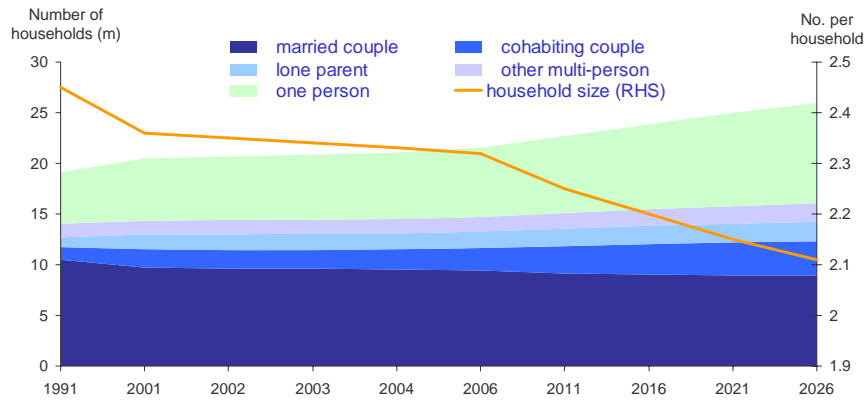
***“The proportion of private renters aged between 20 and 44 who can afford to buy a starter home has fallen from 48% to 21% over the past 10 years”***

“Homes for the Future: more affordable, more sustainable”  
Communities and Local Government  
July 2007

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## Demographic factors: rise of one-person households

- There has been a significant increase in the number of one-person households
  - 1971: 18%
  - 2006: 29%

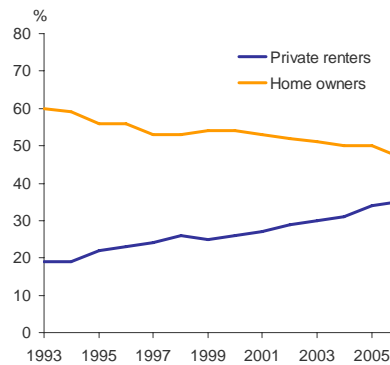


Source: Communities and Local Government

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## Growth in popularity of renting among young people

- Communities and Local Government report highlights the growing popularity of private renting among the young
- The 25-29 year old age group particularly affected
- Proportion of private renters increased from 19% in 1993 to 35% in 2006
- Corresponding decline in home owners
- Many factors are influencing tenure choice, including the relative costs of buying and renting

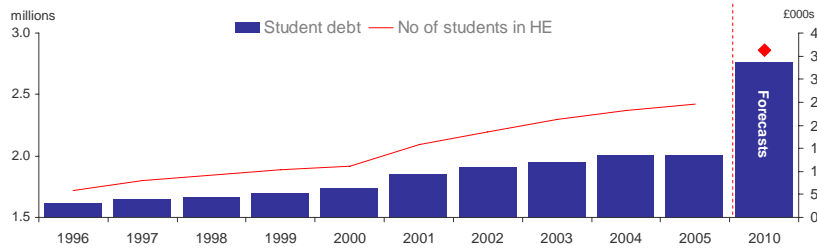


Source: Communities and Local Government - Housing In England 2005/2006

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## Rising student population and graduate debt

- Number of students in higher education up 43% over last decade
- Government committed to increasing the proportion of young people in higher education
  - 50% by 2010 (currently 43%)
  - This could take the number of students to 2.86m in 2010
- Student debt up 380% between 1995-2005, and graduates in 2010 are expected to owe £33,700
- Universities are only able to supply accommodation to 25% of students



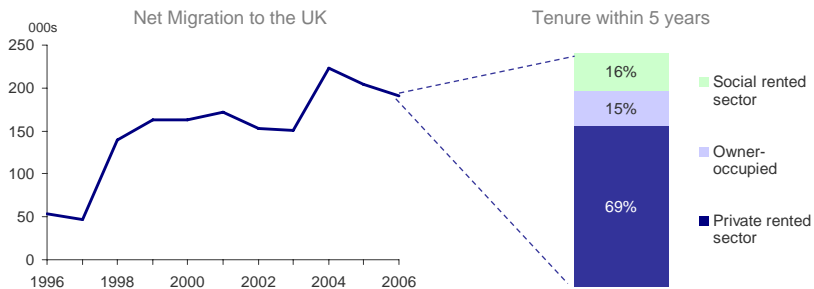
Sources: Higher Education Statistics Agency / Barclay's Student Survey / UNITE

## Inward migration (i)

- In 2006, 591,000 people migrated into the UK
- Increase largely due to EU Accession
- Inward migrants have a greater propensity to rent
- 25% of all householders in the private rented sector are of nationalities other than British or Irish

**"Housing demand simply for new immigrants will increase from 200 a day to 260 a day throughout the next twenty years"**

Sir Andrew Green  
Migrationwatch  
September 2007

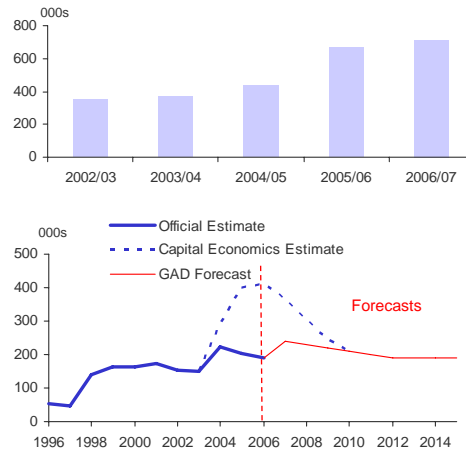


Source: Office for National Statistics / Council of Mortgage Lenders / Communities and Local Government

## Inward migration (ii)

- Migrants from EU accession countries have boosted the number of workers obtaining a UK national insurance number
  - over 80% are under 35 years old
- 120,245 migrants from the A8, Bulgaria and Romania registered with the home office in H107
  - up 15% from 104,590 in H106
- Net migration is forecast to stabilise at a high level
  - GAD: over 200,000 per year for next 5 years; 190,000 per year beyond 2012

Foreign workers obtaining UK NI number

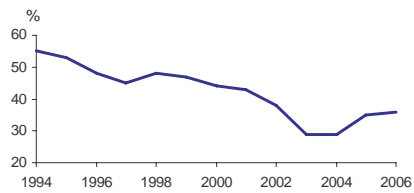
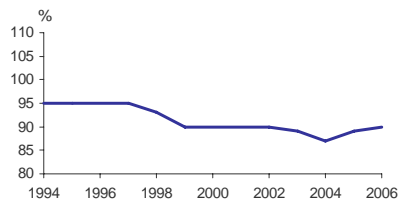


Source: Department for Work and Pensions / Capital Economics / Government Actuary's Department / Office for National Statistics

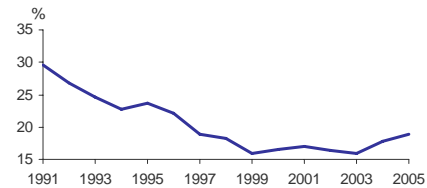
## Decline of first-time buyers (i)

- Affordability constraints, lifestyle choices and rising student numbers are contributing to the decline of first-time buyers
- Average age of FTB now 34 (27 in 1977)
- The average LTV for FTBs fell from 95% in 1994 to 90% in 2006
  - FTBs paying larger deposits

- First-time buyers as a proportion of all buyers has fallen from 55% in 1994 to 36% in 2006



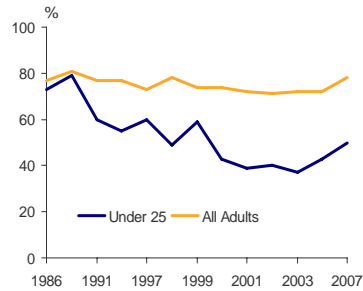
- 19% of first-time buyers were under-25 in 2005, down from 30% in 1991



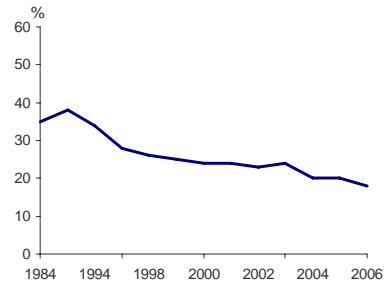
Source: Council of Mortgage Lenders / Communities and Local Government / GE Money Home Lending Survey

## Decline of first-time buyers (ii)

- The proportion of under-25s aspiring to home-ownership within two years has recovered slightly...



- ... but actual home-ownership rates still declining for under-25s - aspirations are not entirely realistic



**“Aspiring first-time-buyers are continuing to rent until the market trend becomes clearer.”**

Jeremy Leaf, RICS, August 2007

Source: Council of Mortgage Lenders / Communities and Local Government

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## Decline of first-time buyers (iii)

Findings of GE Money Home Lending Survey comparing lifestyles in 1977 and 2007:

- In 1977 30% of 25-year olds saw home-ownership as important  
- now only 17% believe it is important, and it is no longer their top priority
- House prices grew by 1,436% over the 30 year period  
- 76% say first-time buyer affordability is now worse than ever before
- 51% of first-time buyers now receive financial support from family

**“The fact that taking the first step onto the property ladder now occurs later in life is due in no small part to economic factors such as house prices.**

**Our analysis also reveals that today’s potential younger buyers also have vastly different attitudes, aspirations and lifestyles to their counterparts 30 years ago.”**

Source: GE Money Home Lending Survey

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## First-time buyer affordability

- House prices have risen by a compound rate of 11.7% a year since 1996 - first-time buyer incomes have risen by a compound rate of 3.5% a year

**“First-time buyers are facing an enormous struggle to access the housing market.”**

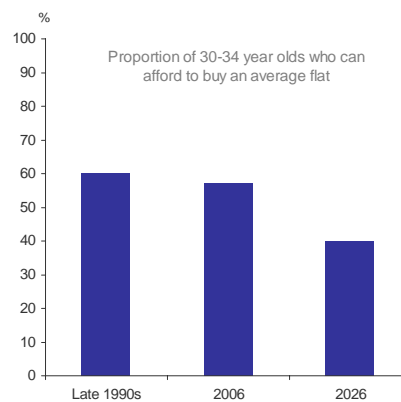
David Stubbs RICS Senior Economist  
5 September 2007

**“The present difficulties of first-time buyers will remain a feature of British society for many years to come.”**

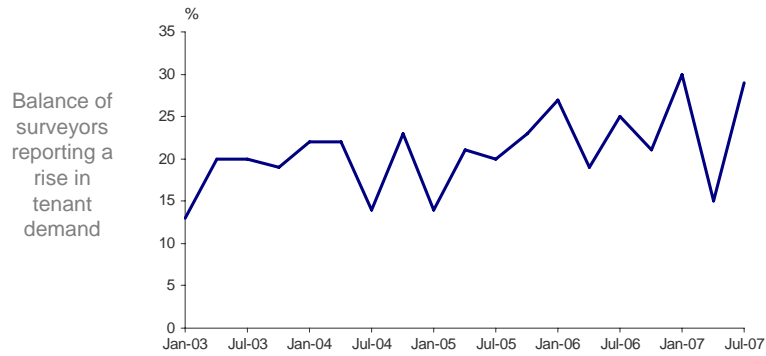
David Stubbs RICS Senior Economist  
5 September 2007

## Declining affordability

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



## Tenant demand

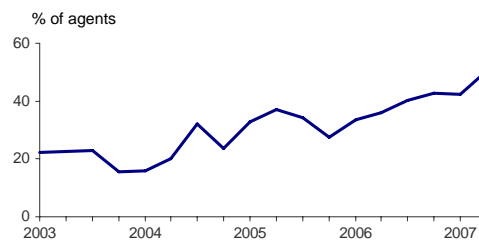


Tenant demand rebounded in July

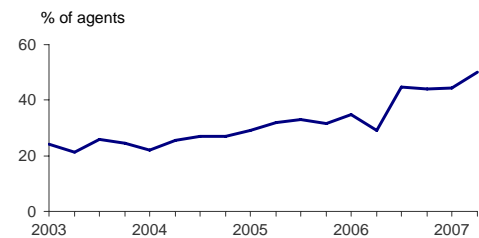
Source: Royal Institution of Chartered Surveyors

## Growing tenant demand is driving rental growth

- The proportion of ARLA agents reporting more tenants than properties is at its highest ever level

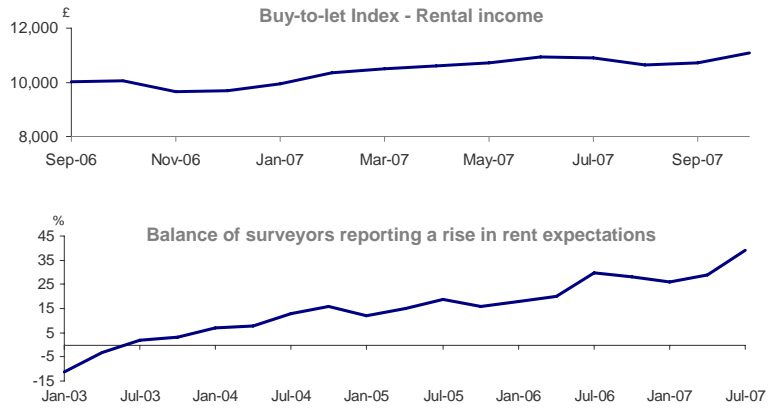


- The proportion of ARLA agents reporting an increase in achievable rent levels has also increased to a record level



Source: Association of Residential Letting Agents

## Rents

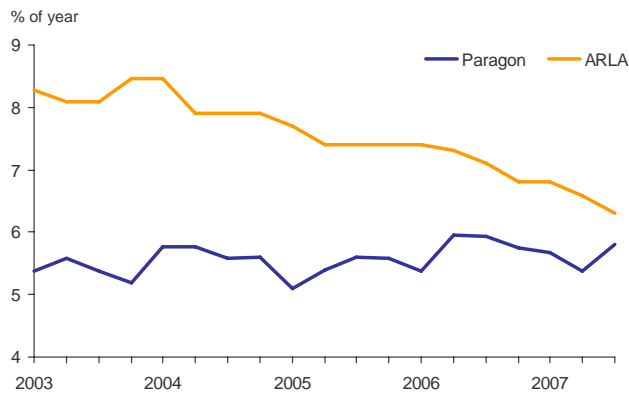


**Tenant demand pushing rents up at fastest ever pace**

Source: Paragon Buy-to-let index / Royal Institution of Chartered Surveyors

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## Voids



**Paragon voids remain below industry average**

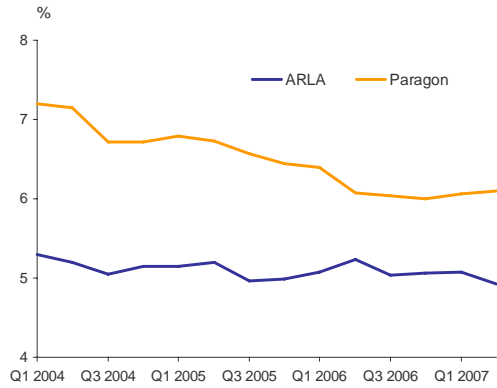
Source: Association of Residential Letting Agents

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## Market rental yields



- Yields have fallen gradually over past two years, from an average of 5.6% to an average of 5.2%
- Only measures yield on day one, takes no account of rental growth
- Capital Economics expect rental yields to improve going forwards



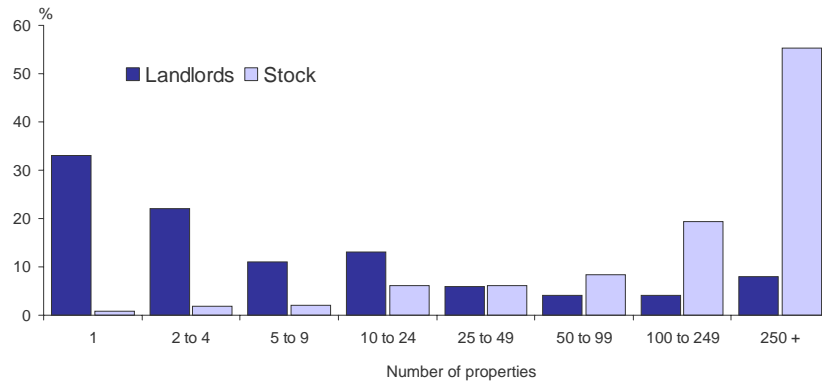
Source: Capital Economics / Paragon

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## Government surveys show that professional landlords hold bulk of private rented sector stock



- The majority of landlords own a small number of properties  
-55% of landlords own 3% of stock
- The majority of stock however is owned by professional landlords with large portfolios  
-12% of landlords own 75% of stock

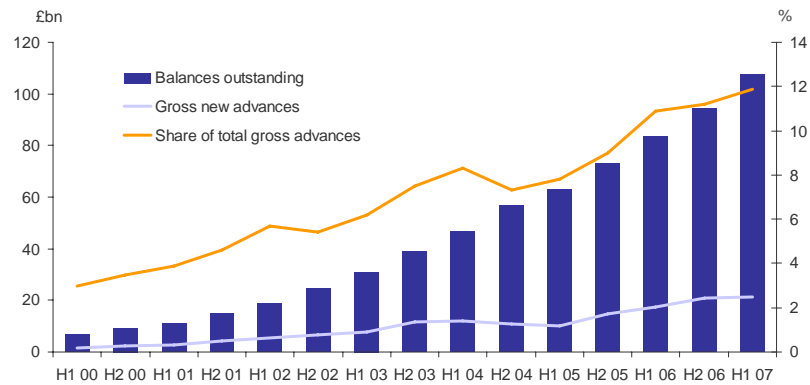


Source: Communities and Local Government Private Landlords Survey

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## UK buy-to-let market

The buy-to-let sector is seeing strong volume growth and accounts for an ever-bigger share of the UK mortgage market



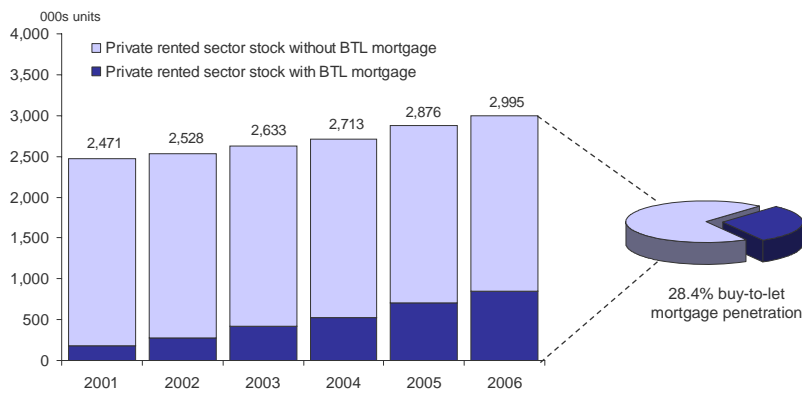
Source: Council of Mortgage Lenders

(Note: Figures are for calendar years)

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## Low debt penetration in the private rented sector

- The number of buy-to-let mortgages as a proportion of the private rented sector is growing
- However, debt penetration in the sector is still low – there is room for further growth



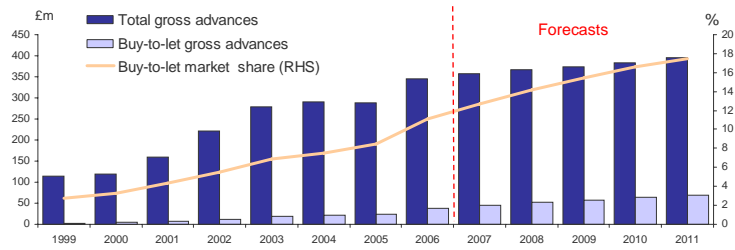
Source Council of Mortgage Lenders / Communities and Local Government

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## Long-term growth prospects

**“Sustained tenant demand driven by a number of factors such as the difficulty of first-time buyers in getting on the property ladder, a change in lifestyle, a need for more flexibility and a growing immigrant population suggests that the future is bright for buy-to-let.”**

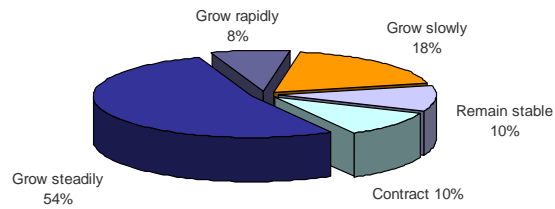
UK Buy-to-let Mortgages 2007, Datamonitor



Source: Datamonitor

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## What will happen to the buy-to-let sector in the future?

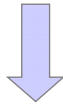


**80% of intermediaries believe that the buy-to-let sector will continue to grow in the future**

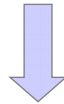
Source: Datamonitor

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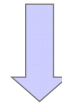
**Latest ARLA survey shows positive mood amongst landlords with key data showing significant improvement**



90% of ARLA landlords said they would hold their buy-to-let investment even if house prices fall

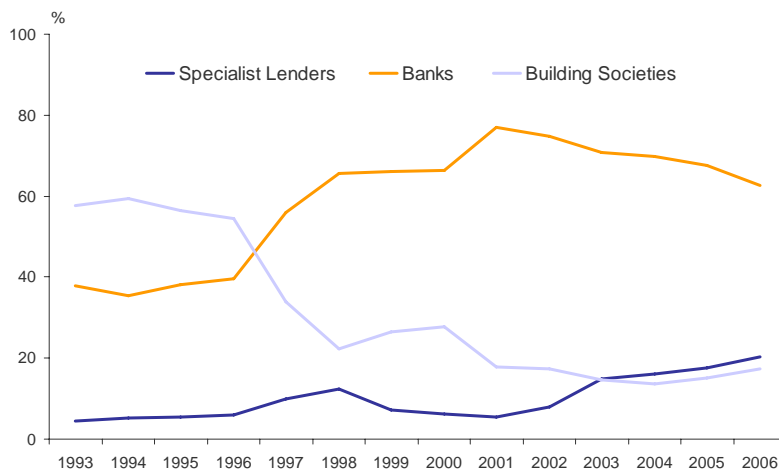


54% intend to acquire further buy-to-let investments during the next 12 months



66% said the average life expectancy of their property investment is 10 years or more

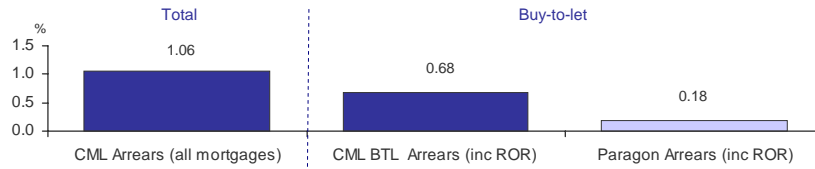
Source: Association of Residential Lettings Agent Review & Index of Residential Investment (Q3:2007)



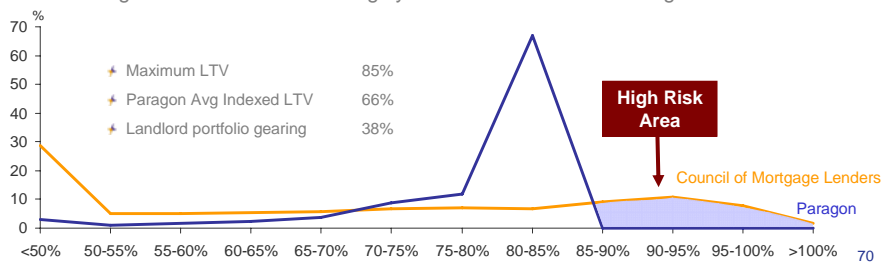
Source: Council of Mortgage Lenders

## Credit quality – buy-to-let

Buy-to-let arrears are lower than wider mortgage market arrears  
Paragon arrears are significantly below the industry average



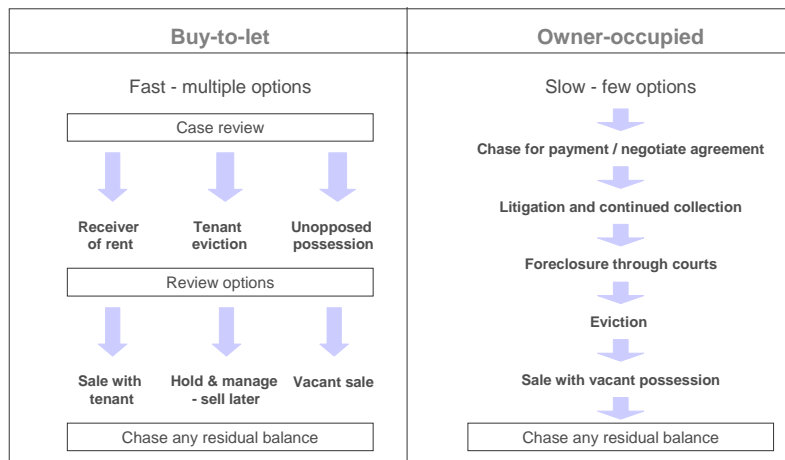
Paragon's LTV distribution is highly conservative and avoids high risk areas



Source: Council of Mortgage Lenders / Paragon

## Buy-to-let enforcement process

Buy-to-let enforcement is a clearly defined process which is simpler and costs less than the owner-occupied methodologies



## The positive impact of buy-to-let

- Provision of high quality rental accommodation
  - tenure of first choice, not last resort
- Crucial contribution to private rented sector
  - provides flexible, affordable accommodation
  - allows realisation of changed lifestyle preferences
- Source of stability during market downturn
  - investors take long-term view
  - potential first-time buyers not forced into ownership before they can afford it
  - arrears low relative to wider mortgage market
- Realistic option for those who want to create an income source for their retirement

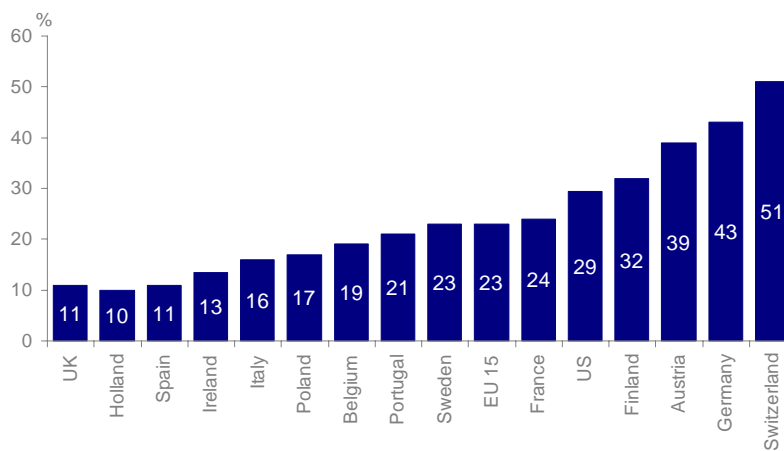
**“ Buy-to-let mortgage lending has grown strongly in the last decade and has made an important contribution to meeting rising tenant demand”**

Council of Mortgage Lenders' Response to  
Communities and Local Government Consultation Paper, October 2007

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## UK private rented sector: international context

UK private rented sector small as a proportion of housing stock compared with other EU countries and USA



Sources: RICS / World Bank / CSO (Ireland) / American Housing Survey

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