

paragon

Half-yearly financial results

Six months ended 31 March 2010

The Paragon Group of Companies PLC



Agenda



Section 1	Financial results
Section 2	Strategy
Appendix:	
Section 3	Buy-to-let overview

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Section 1

Financial results
Six months ended 31 March 2010



Financial highlights

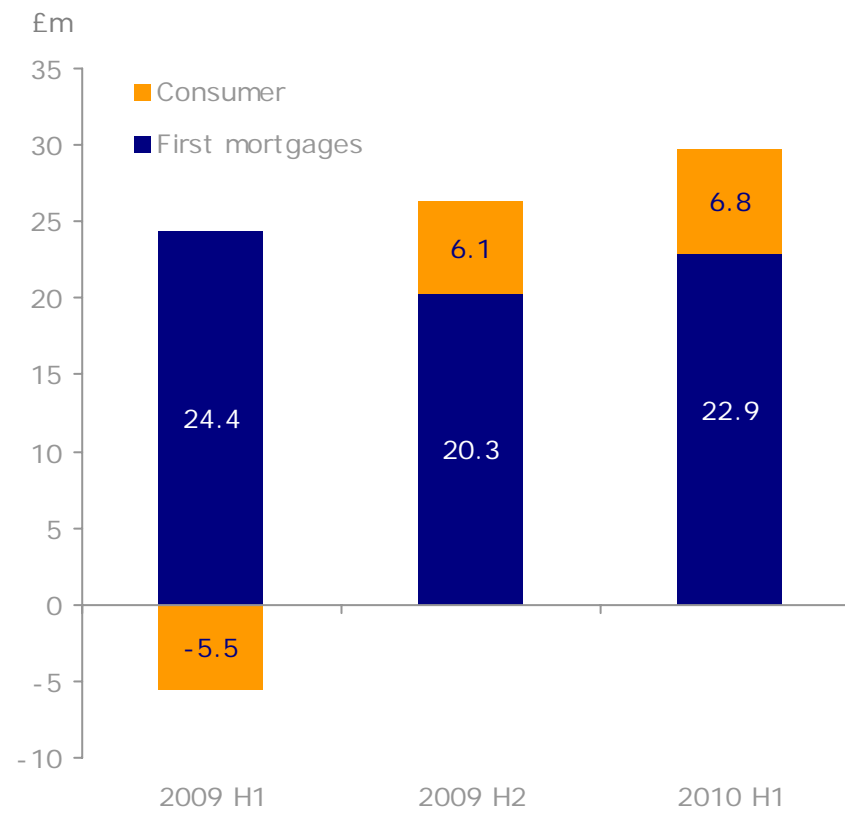
	2009 H1 £m	2010 H1 £m	% change
Pre-tax profit	15.9	29.3	84.3%
Of which:			
Exceptionals		0.5	-
Fair value	-3.0	-0.9	-70.0%
Underlying profit	18.9	29.7	57.1%
Tax rate	29.6%	28.0%	
Dividend per share (interim)	1.1p	1.2p	9.1%
Earnings per share	3.8p	7.1p	86.8%
Shareholder funds @ 31 March	£625.5m	£664.9m	6.3%

Operating profit

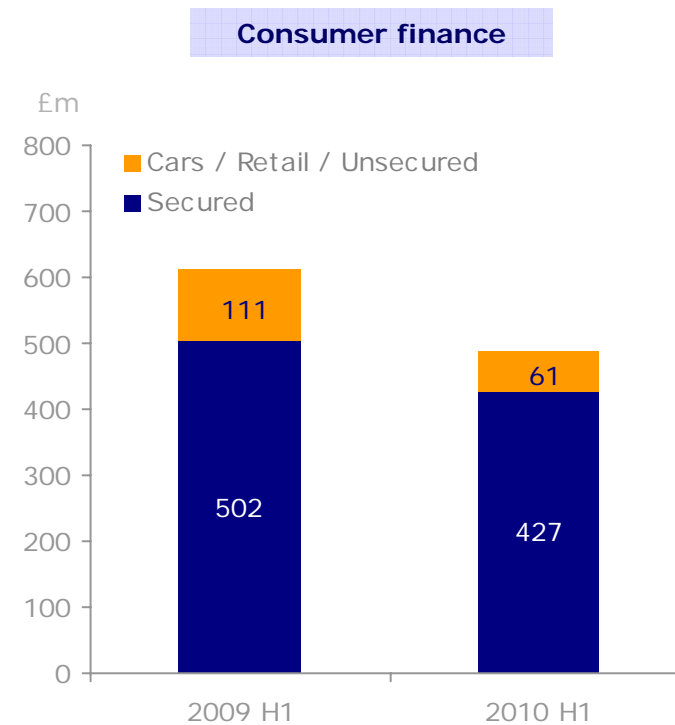
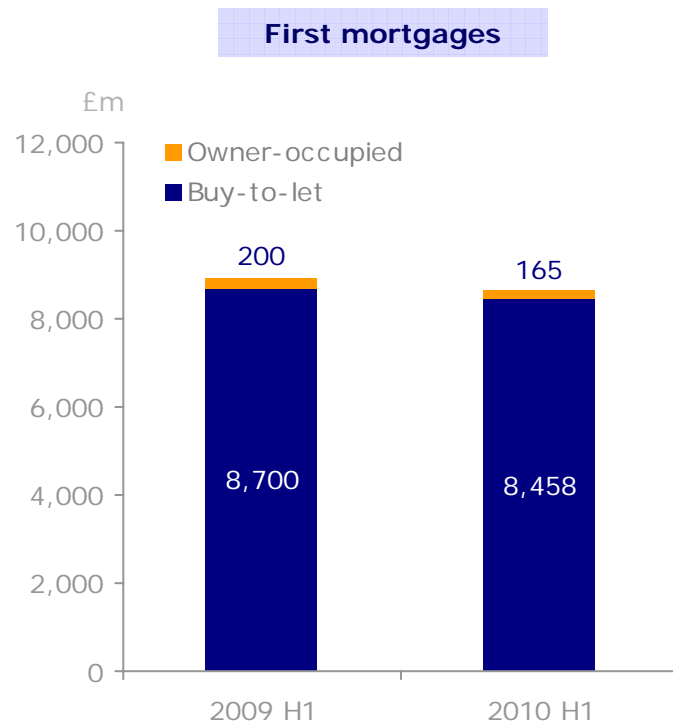


	2009 H1 £m	2009 H2 £m	2010 H1 £m
Underlying profit	18.9	26.4	29.7
Of which: Impairments	-38.7	-27.5	-26.7
Income	76.5	74.3	77.4
Costs	-18.9	-20.4	-21.0
Cost:income	24.7%	27.5%	27.1%

Segmental profit analysis



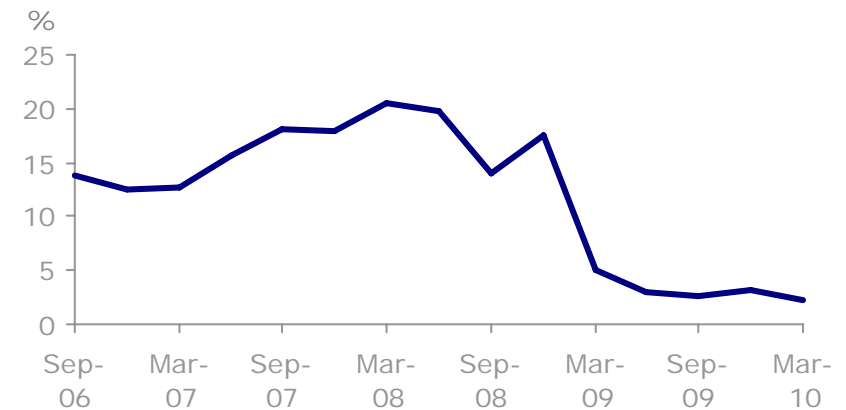
Paragon segmental loan assets



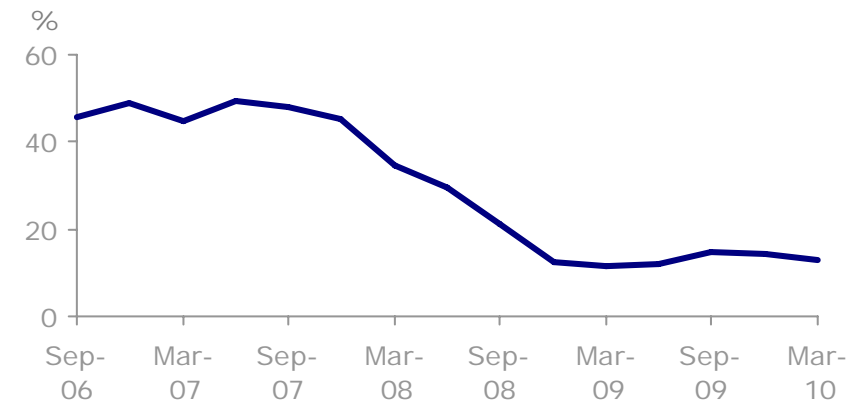
Segmental redemption rates

- Buy-to-let redemption rate has stabilised below 3% per annum
- Buy-to-let reversionary rates continue to compare favourably to current market rates
- Secured redemption rate has stabilised at c14% per annum
- Competition in both markets remains restricted

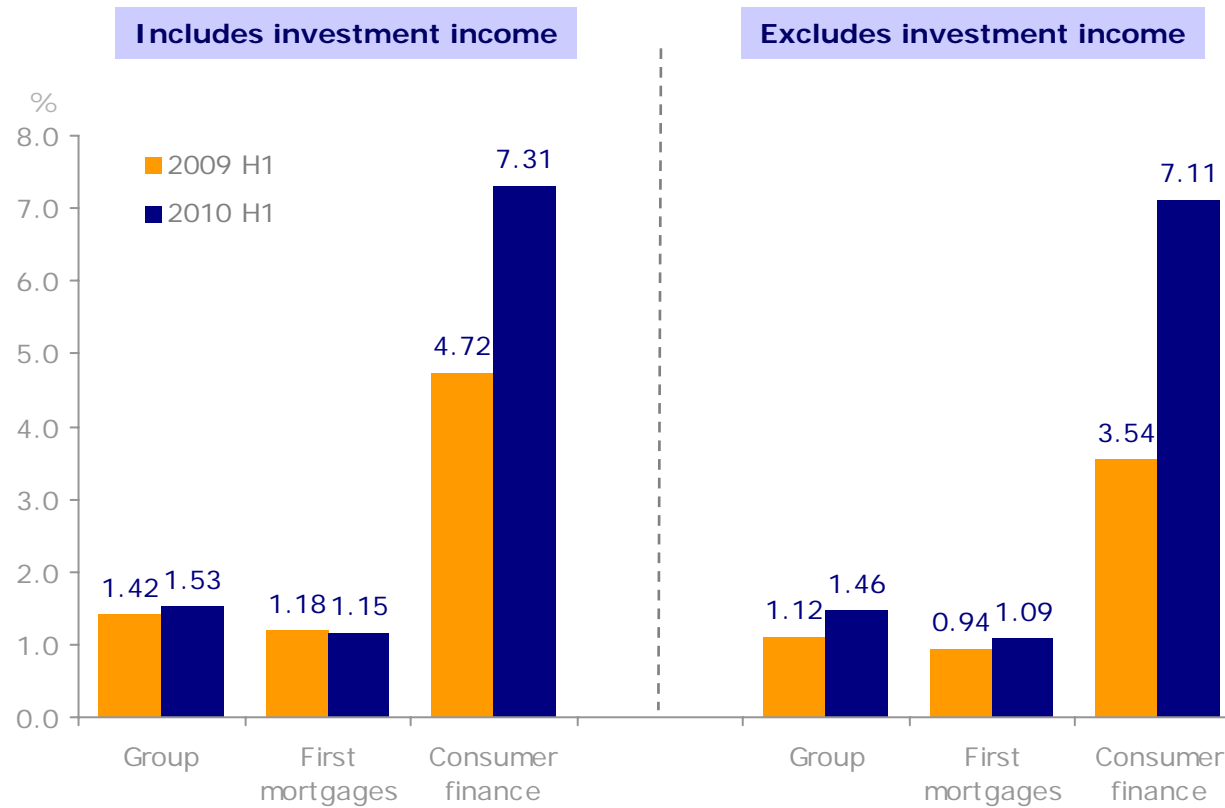
Paragon buy-to-let redemption rate



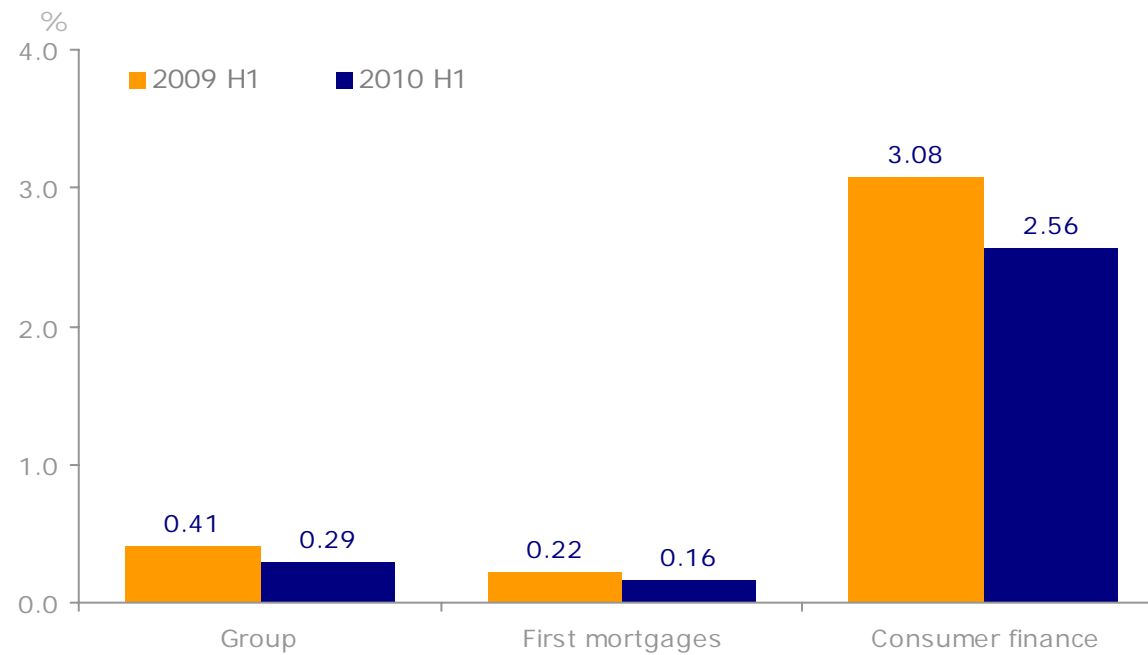
Paragon secured redemption rate



Net interest margin

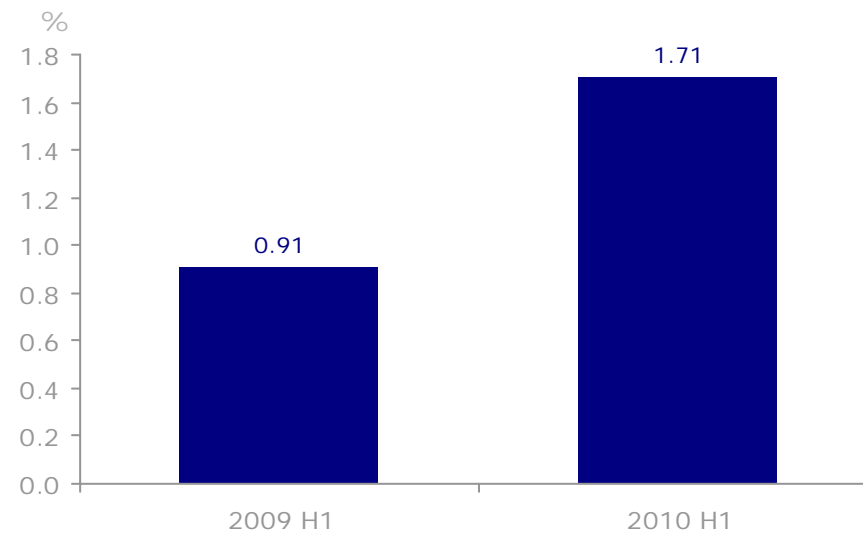


Impairment charge as % of total loan assets



Cash margins

- Cash margin consistent with 2009 H2
- Free cash balances at 31 March: £128.1m



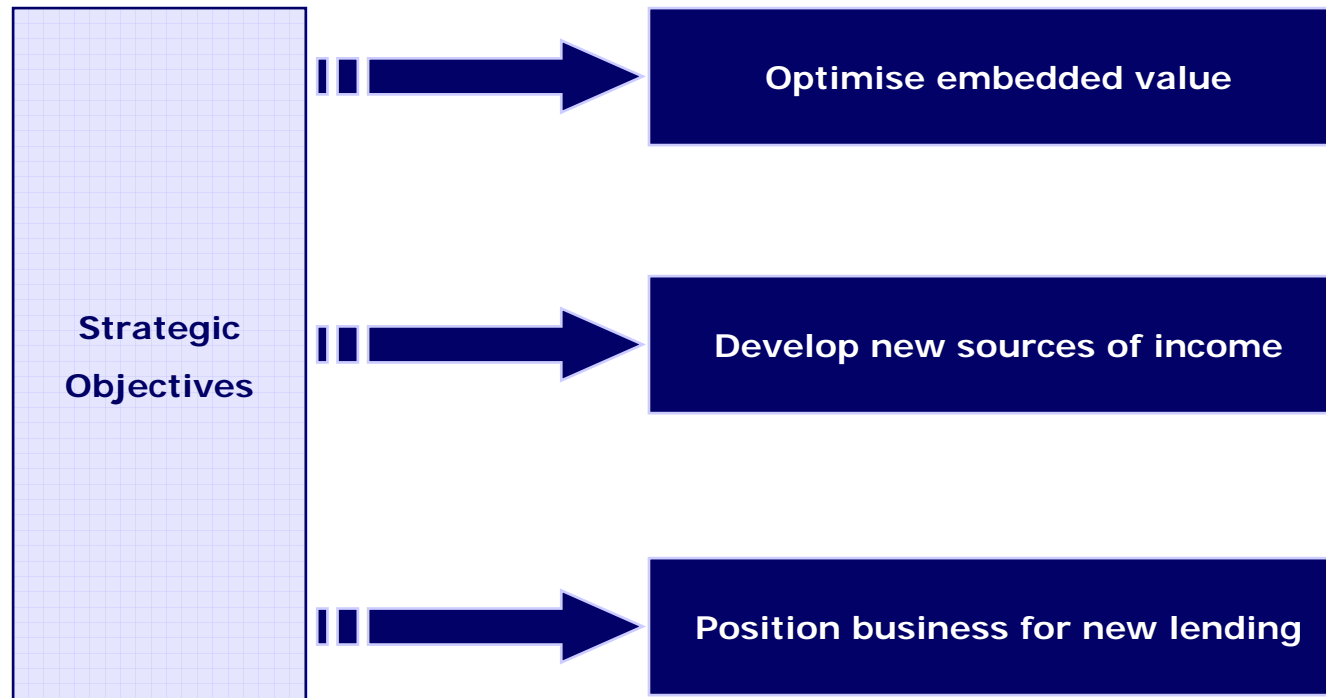
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Section 2

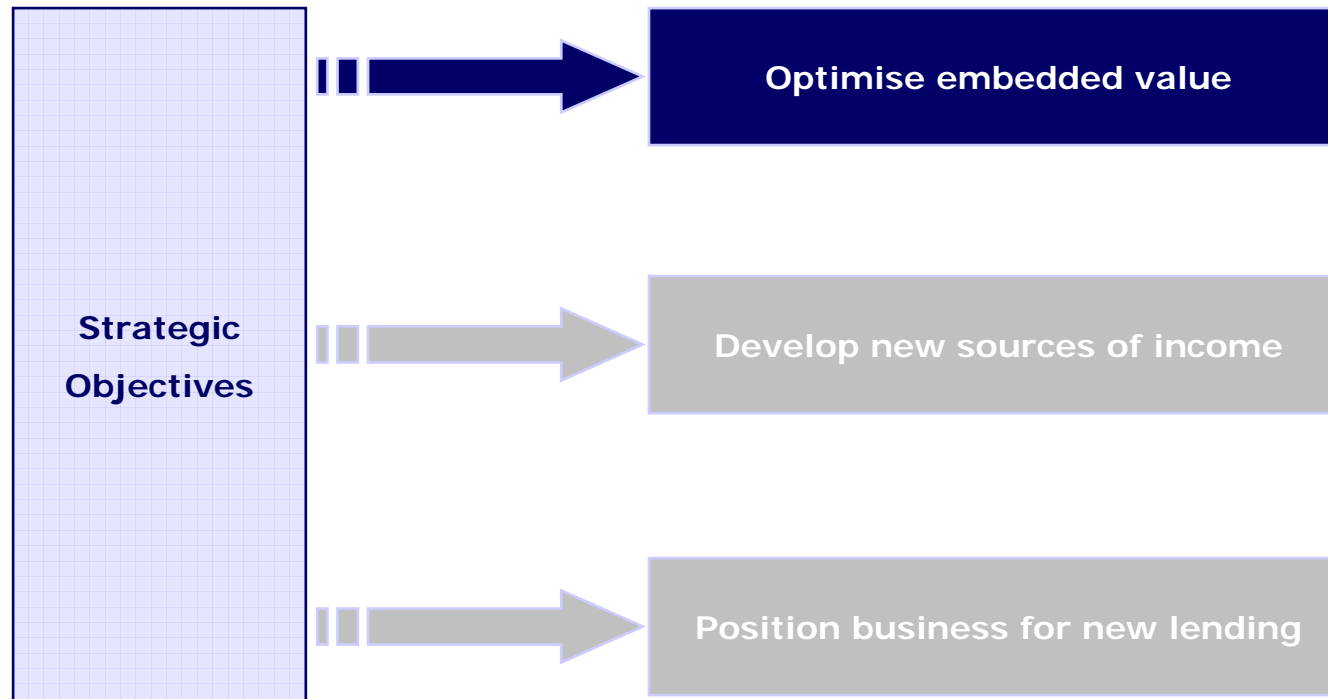
Strategy



Strategic objectives



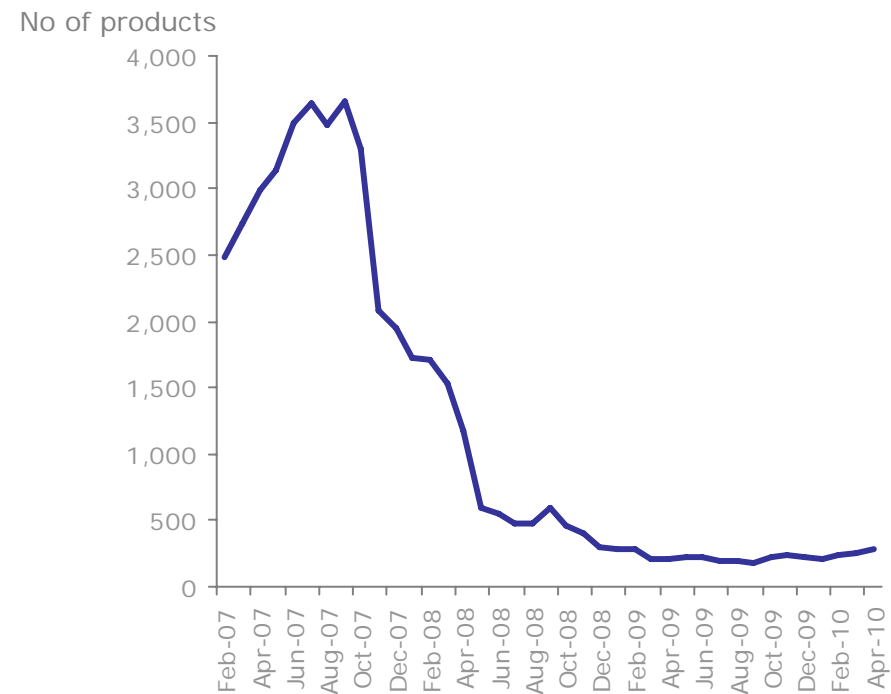
Strategic objectives



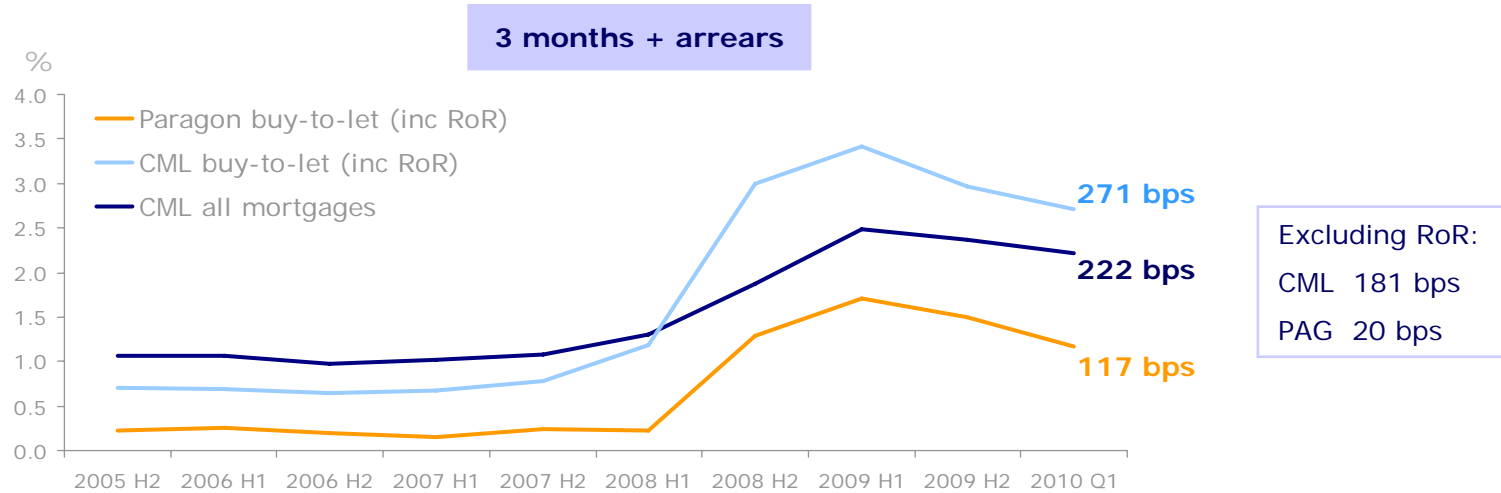
Customer retention

92% fall in available BTL loan products since 2007

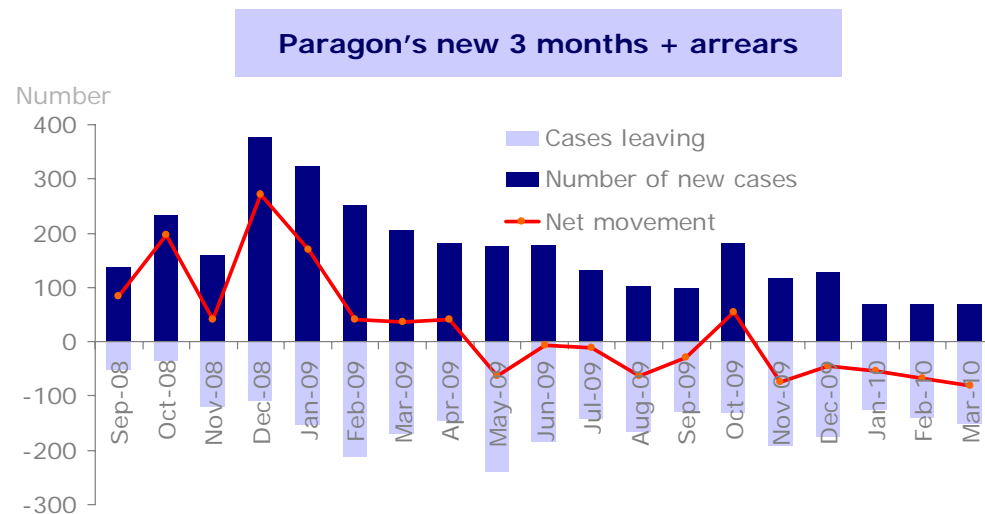
- Buy-to-let redemption rates below 3% pa (traditionally 20% pa)
- Remortgage market weak
 - Competitive pricing significantly wider than our terms
- Market criteria remains restricted
- Regulatory environment will continue to keep margins wide
- Fixed rate switch opportunities offered to existing customers



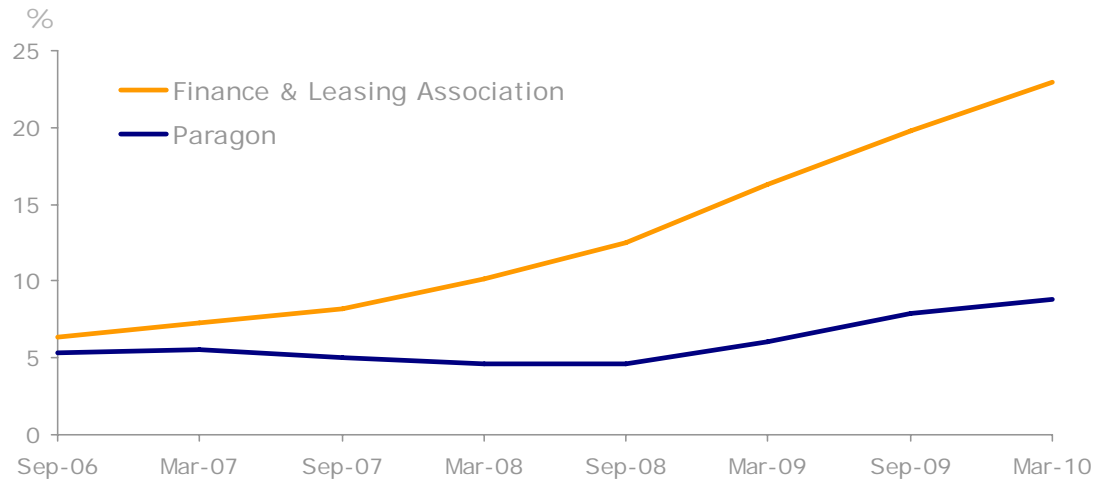
Buy-to-let arrears



- Arrears levels have continued to improve
- Paragon arrears trends still outperform the wider BTL market
- New arrears flow continues to slow



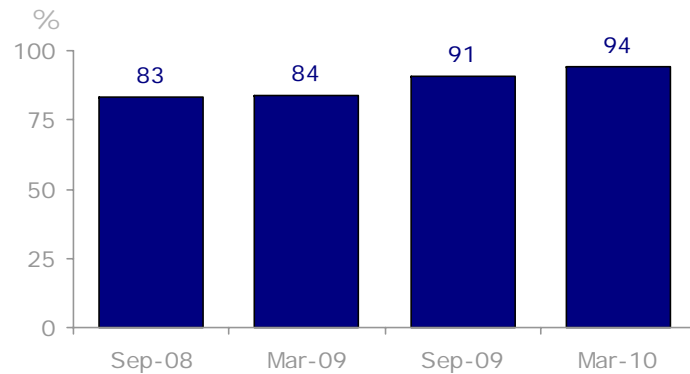
Consumer (secured) arrears



- Paragon’s secured arrears remain significantly below industry averages
- Successful collections activity – 79% average monthly received v due

Receiver of Rent

94% of RoR properties let



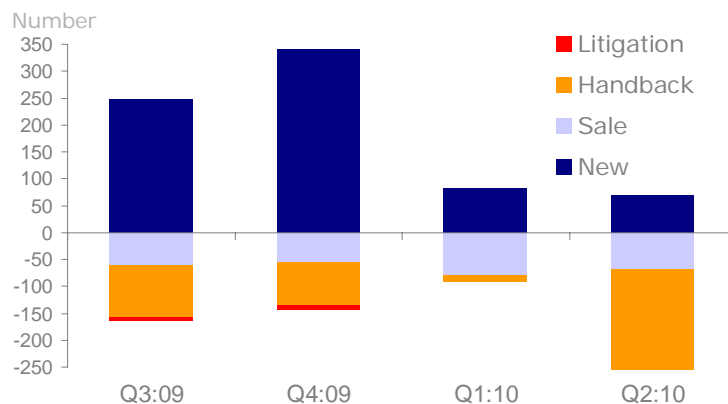
86% of 3 months plus arrears are subject to Receiver of Rent

94% of Receiver of Rent properties are let

Interest cover ratio (on RoR let properties)
= 1.9x covered

To date 27% of RoR cases resulted in sale of property, whereas 30% of RoR cases returned to customer performing, the latter is expected to increase over time

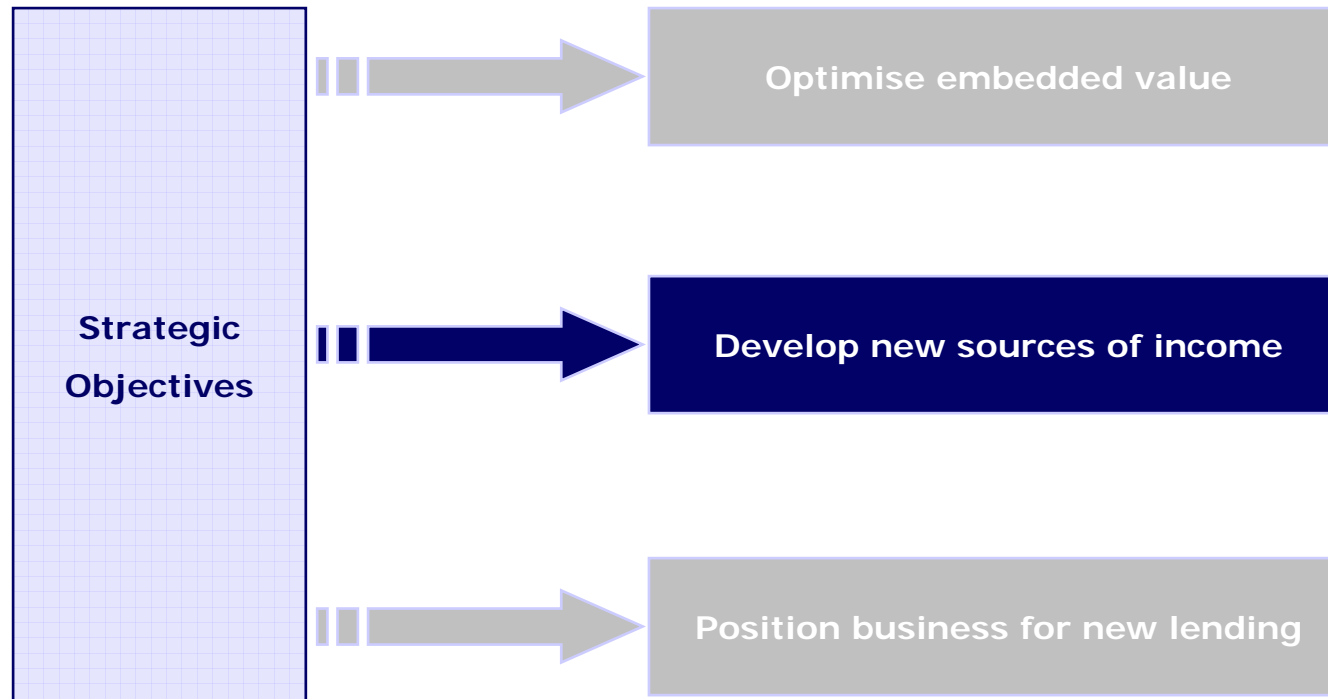
Stock movement shifts to customer handbacks



What if interest rates rise?

- Interest rate outlook
 - Base rate at historic lows but will rise at some stage
 - However, likely to remain low for some time
 - Wider lending spreads is a form of monetary tightening
- Portfolio profile
 - Existing portfolio largely originated between 2001 and 2007 when base rates averaged 4.6%
 - Current fixed rate loan book arrears 1.29% with rates averaging 5.5%, compares favourably with portfolio (1.17%)
 - Receiver of Rent interest cover ratio 1.9x rising to 2.3x as fixed rates convert
 - Performing book interest cover ratio in excess of 3x by 30/9/10 as fixed rates convert
- Impact of interest rates on net assets
 - Paragon's capital invested in financial assets largely held in cash (total £514.7 million)
 - Return on this invested cash will rise as interest rates rise

Strategic objectives

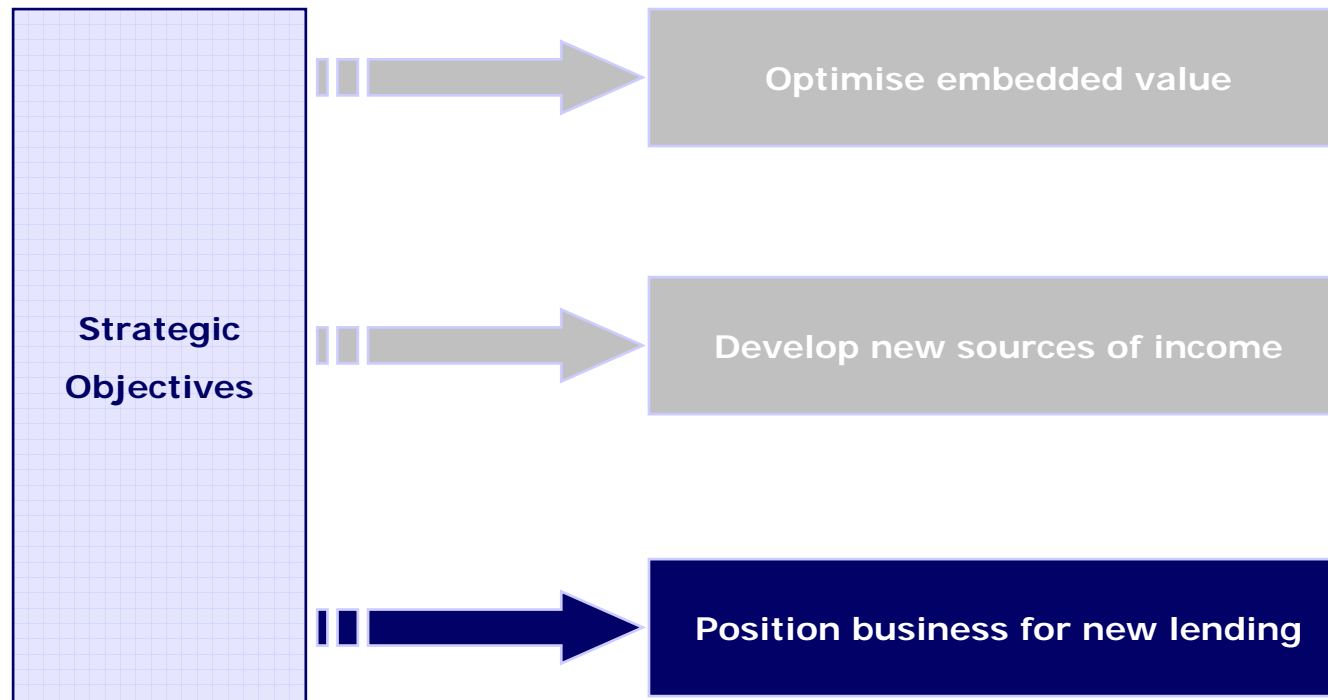


Strategic focus on new sources of income

- Good progress made in 2010 to date
 - Expected to contribute £3.5 million for FY09/10
 - Delivered £2.4 million in H1
- Loan servicing
 - c15k additional specialist servicing accounts
- Portfolio acquisitions
 - Transactions have long gestation period – 3/4 year market, will accelerate as Government seeks repayment
 - Bond prices have continued to increase, opportunities reduced



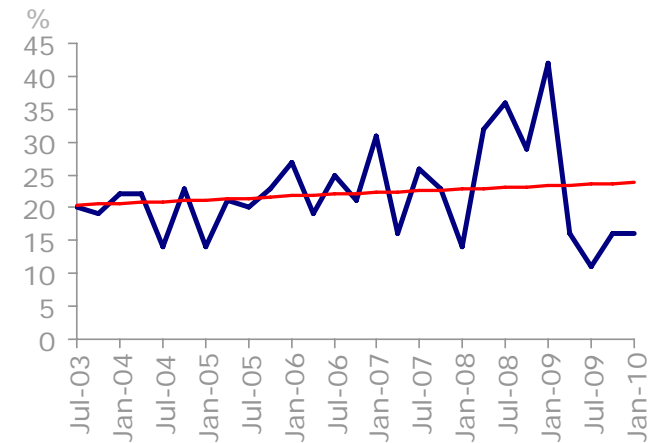
Strategic objectives



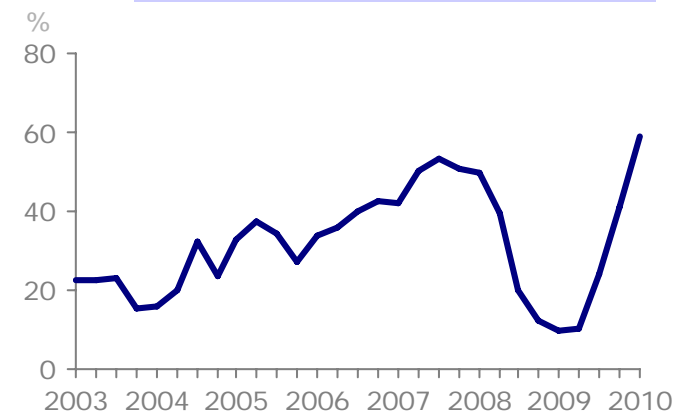
Landlord demand

- Long-term fundamentals remain favourable
- Cyclical effects driving up tenant demand
- Accidental landlords largely vacated market
- Rental yields remain robust
- Datamonitor mean forecast 2010 market gross lending £10.6 billion

Balance of surveyors reporting a rise in tenant demand

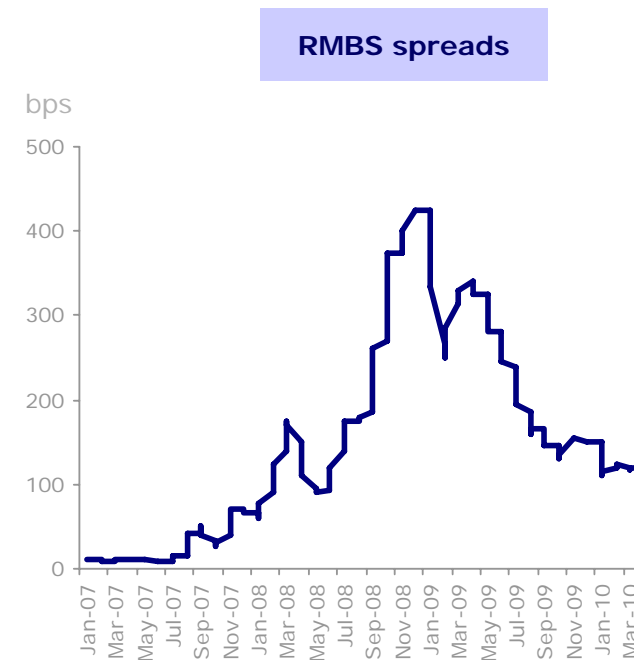


59% letting agents reported more tenants than properties



Funding

- £7.01 billion RMBS issued and distributed in H1
- £2.70 billion RMBS issued and distributed since 31/3/10
- AAA spreads have tightened
- Mezzanine / sub-debt market has outperformed senior
- Pre-credit crunch non-put structures returning
- Asset backed mortgages more resilient in recent Eurozone crisis



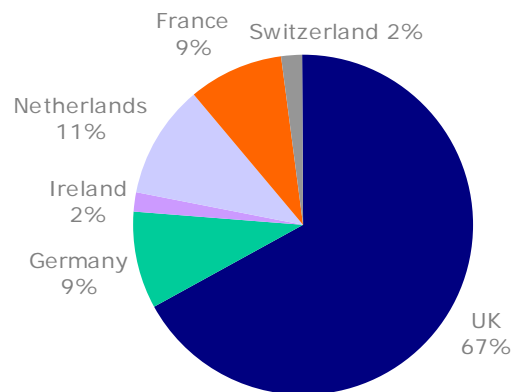
Securitisation investor appetite

- Investor appetite has increased across the credit spectrum
- Recent transaction extended demand to Europe and USA
- Recent deals evidenced a substantial increase in number and range of investors

“Paragon deals rank among the best performing RMBS in Europe, with severe delinquencies below 1% and fully funded reserves.”

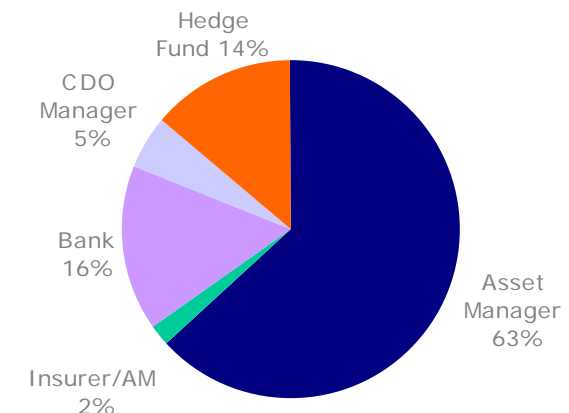
MORGAN STANLEY
May 2010

Roadshow bond investor location



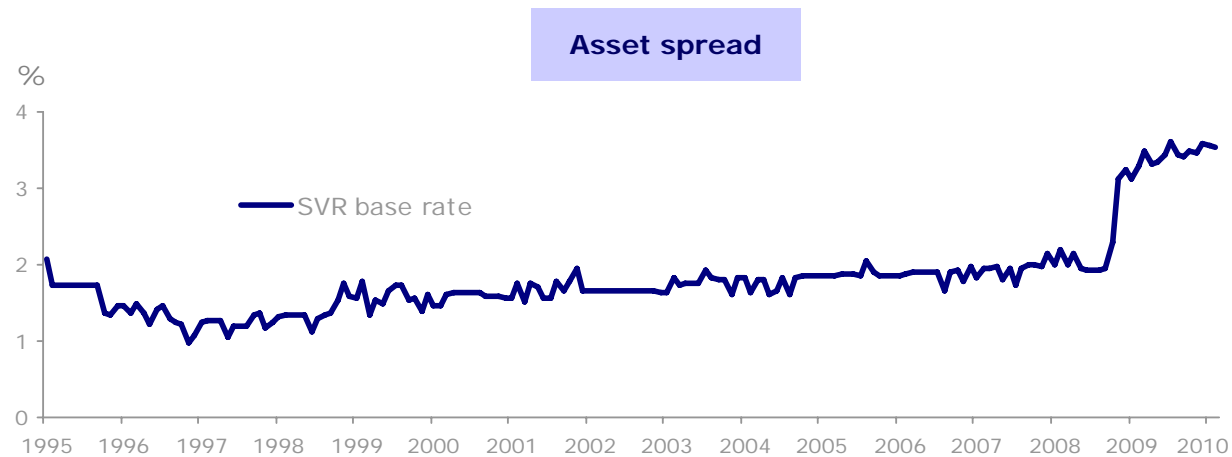
- Extensive non-deal specific bond roadshow in February
- Bond investors signalled strong support
- Clear recognition of Paragon’s performance as:
 - Loan underwriter
 - Loan servicer

Roadshow bond investor type



Lending economics

- Funding costs and capital requirements have increased generally
- ... but so have margins
- Detailed feasibility assessment undertaken with banks, investors and rating agencies
- Application of prudent assumptions – including capital at 5% CRD minimum
- Top line revenue growth achievable at much lower levels of gross lending than historically due to reduced redemption levels and new lending margins



- Buy-to-let mortgages
 - Initial consultation highlighted commercial nature of sector
 - HM Treasury reassessing scope of buy-to-let regulation
- Second charge mortgages
 - Regulation being transferred from OFT to FSA
- Non-deposit taking lenders
 - FSA due to publish consultation paper in Q3: 10

Operational requirements

- Operationally well positioned to commence new lending
 - Internal resources retained
 - Systems already established
 - Marginal costs to recommence lending will be modest
- Core distribution relationships have been maintained
 - Commercial finance brokers
 - TBMC
- Modest activity required to achieve balance sheet and earnings growth
- Warehouse discussion progressing, but we will only enter into new funding when entirely satisfied

Conclusion

- Excellent portfolio performance
 - Strong revenue and cash generation
 - Outstanding credit results
- New income sources progressing well, further opportunities exist
- Return to new lending key objective
 - Securitisation market improving
 - Warehouse discussions progressing
 - New lending economics appear feasible

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Section 3

Buy-to-let overview



- Private rented sector
- Buy-to-let market
- Tenants
- Landlords

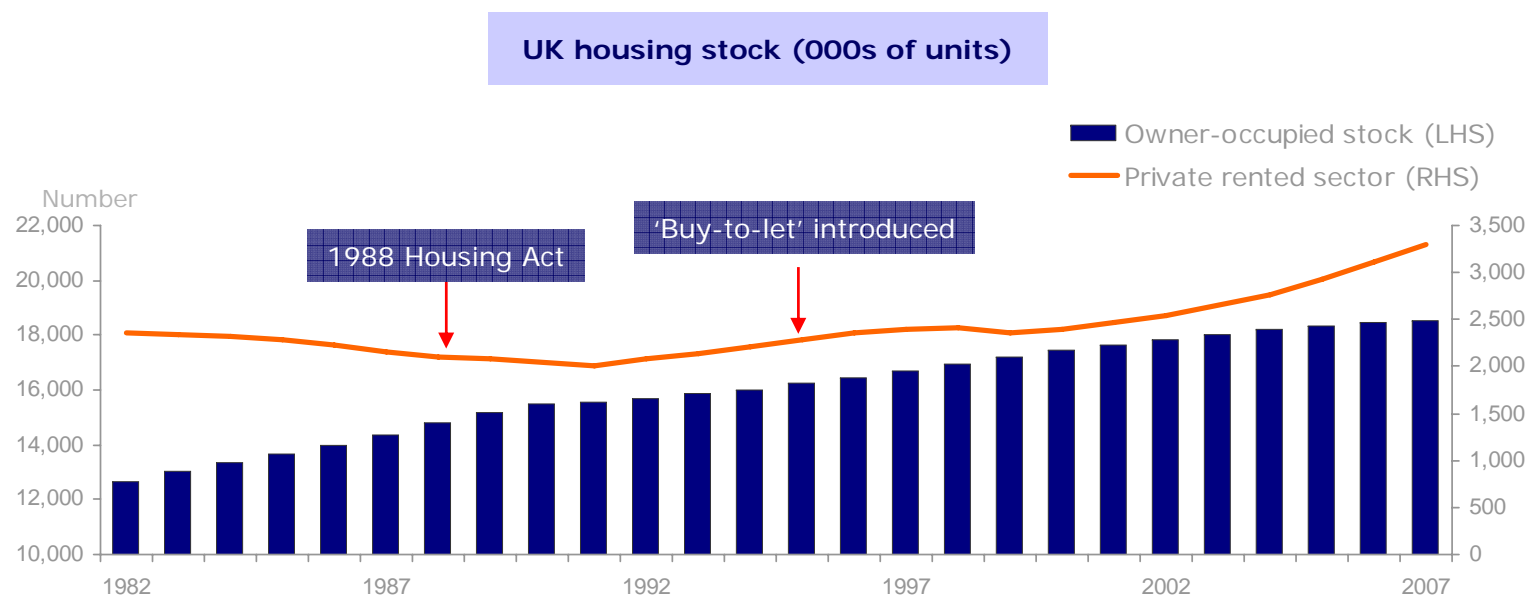
Buy-to-let overview

Private rented sector



PRS – brief history

- Prior to 1988 Housing Act, PRS in long-term decline
 - Act reformed landlord / tenant legislation
- In early 1990s, PRS grew rapidly
 - Recession affected first-time buyer confidence
 - Falling house prices combined with strong rental demand improved yields
 - Professional landlords took advantage of purchase opportunities
- Expansion continued in early 2000s
 - Rapid house price inflation priced first-time buyers out
 - Strong tenant demand supports rental incomes
- Owner-occupation peaked at 70.9% of households in England in 2003
 - Fell to 67.9% in 2008/09
- PRS shown persistent growth
 - Now accounts for 14.2% of English households, from 10% in 2001



Government housing policy: future plans

- 118,000 new home completions in 2009 - 51% below 240,000 per annum Labour Government target
- Target shortfall likely to increase
 - Housing starts in England fell by 36.8% in 2008 and by a further 36.2% in 2009 Q1-Q3
- Social housing completions remain low
 - Currently 1.8 million on social housing waiting lists, up 70% over last 10 years
 - National Housing Federation expects recession to push waiting lists to over 2 million by 2011
- NHPAU estimates up to 290,500 extra home needed per year on average between 2008 - 2031
- New Government's future plans ?

Rugg review recommendations

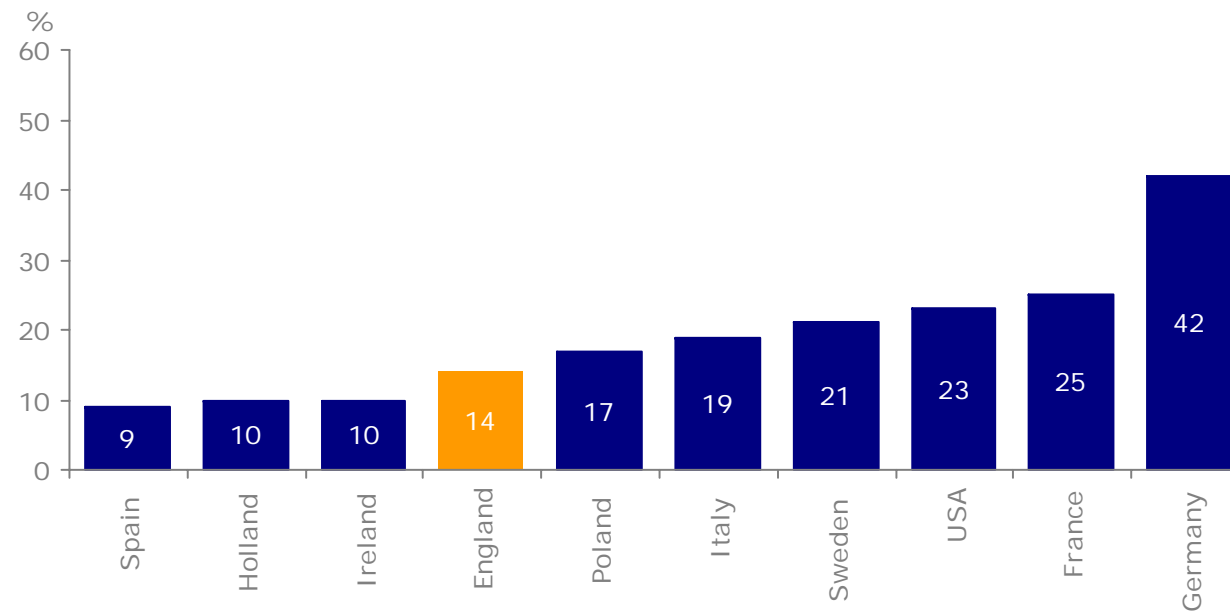
- Government initiatives to encourage landlords to grow their property business
- Changes to tax regime to encourage landlords to become full-time managers of their property business
- Mandatory regulation for managing agents
- Light-touch licensing for landlords in the PRS
- Initiatives to encourage low-income households to use PRS in addition to social housing

“The PRS is a key component of the housing market in England. The flexibility of the PRS needs to be protected, and policy interventions should flow with the market rather than seek to change its essential characteristics.”

Rugg Review of PRS

Private rented sector: international context

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

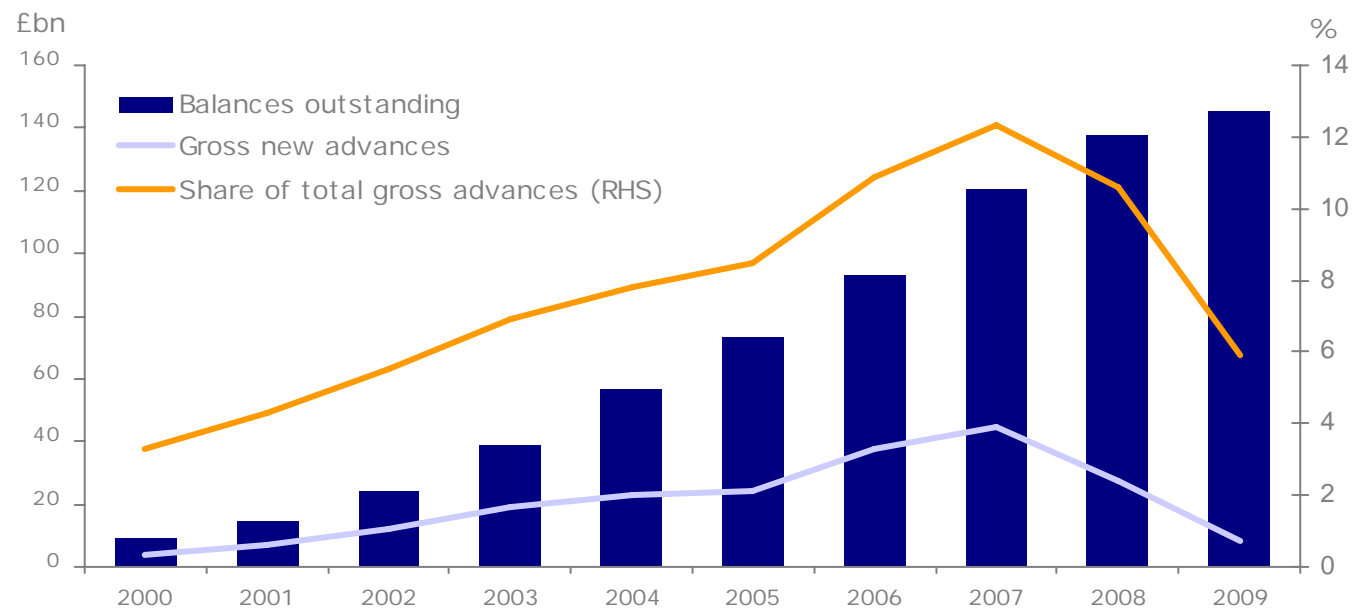


Buy-to-let overview

Buy-to-let market



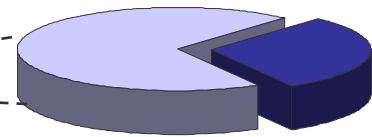
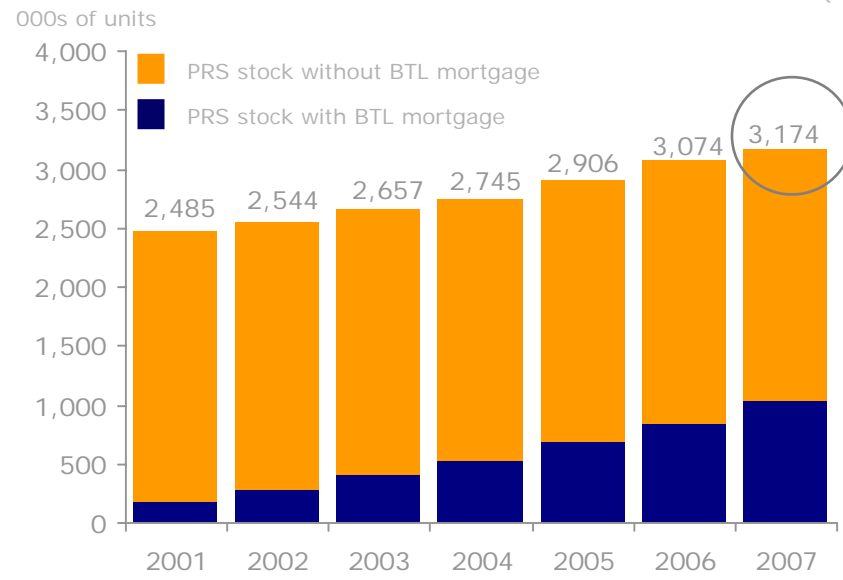
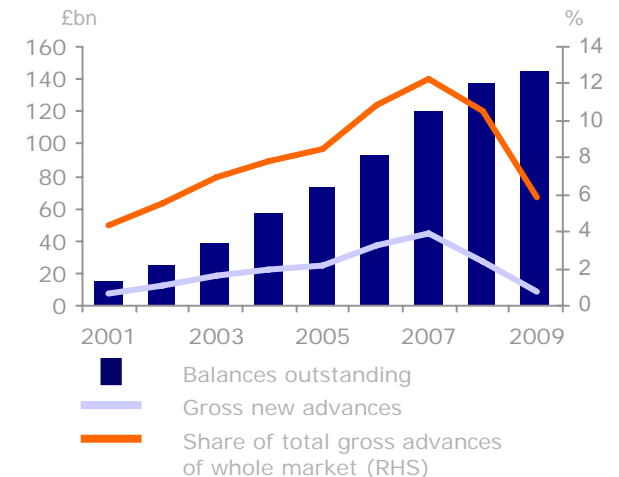
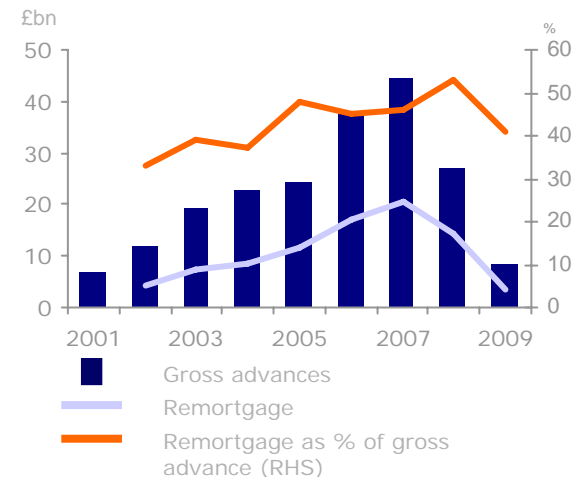
UK buy-to-let market



Low debt penetration in the UK private rented sector

Remortgaging accounted for 41% of 2009 gross advances

- Until 2008, BTL gross advances had been increasing
- However, remortgaging accounted for increasing proportion of business – over 50% by 2008
- Suggests that while overall market increasing, does not necessarily equate to proportion of new landlords and properties in PRS



32.7% buy-to-let mortgage penetration in 2007
58.5% owner-occupation

- Debt penetration in PRS still low
- Landlords take conservative approach to gearing
- Growth in BTL inflated due to absence of commercial lenders' reporting

"The modern private rented sector is helping to stabilise the housing market because it is housing people who, if they had become owner-occupiers in the past few years, would at this stage in the housing market be over-stretched borrowers with rising negative equity."

Professor Michael Ball - The Modern UK Housing Market Origins and Prospects - ARLA

What is buy-to-let?

- Buy-to-let is commercial finance used for a commercial purpose
 - A business that landlords engage in
 - Not speculative
- Buy-to-let requires:
 - Property that can be let on a sustainable basis
 - Generation of rental income that exceeds costs of holding/running the property
 - A long-term outlook
- Dominated by professional landlords

“Owning investment property is not like owning your own home. Instead you are effectively running a small business.”

Council of Mortgage Lenders

“Buy-to-let is a commercial venture and consequently the risks associated with such a venture (including the risk to the investor’s own home) are no different to those for other types of business venture or other forms of debt, regulated or otherwise.”

Legislative Reform (Consumer Credit) Order 2008 – Explanatory Document, BERR

Buy-to-let is not...

Speculative investment

- Consumer “sold” property investment by third parties
- Includes buying off-plan
- Often intention to flip property, not rent out
- Focus on capital appreciation only
- Typically minimal property management experience

City centre new build flats

- Media gives impression that the majority of buy-to-let is city centre new builds
- “... BTL mortgages are not specifically associated with new build.”
Stephen Nickell
Oxford Economics
Professor and former MPC member
BPF Conference 2008

Property investment clubs

- Promoted property investment through high pressure sales techniques
- Close association with problematic areas such as city centre new builds

“It is only off-plan and new build speculation.....that are the primary cause of the problems in the market. The speculation is not, and never has been, buy-to-let. It is greedy speculators believing a small deposit and rapid capital growth would allow them to flip the contract and make a killing.”

Association of Residential Letting Agents

The positive impact of buy-to-let

- Provision of high quality rental accommodation
 - Number of homes in PRS meeting “decent homes standard” increased from 750,000 in 1996 to 1.6 million in 2008
- Crucial contribution to UK 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 remain lower than in wider mortgage market
- Realistic option for those who want to create an income source for their retirement

“The modern private rented sector is helping to stabilise the housing market because it is housing people who, if they had become owner-occupiers in the past few years, would at this stage in the housing market be over-stretched borrowers with rising negative equity.”

Professor Michael Ball, *“The Modern UK Housing Market - Origins and Prospects”*, ARLA

Attractions of buy-to-let market

Superior credit features

- Borrowers have multiple sources of income and reduced risk through portfolio diversification
- Sophisticated borrower profile
- Less sensitive to current macro-economic pressures:
 - **High unemployment:** increased demand for rental property
 - **Falling property prices:** landlords unaffected as long as property remains tenanted and still has a positive yield
 - **Rising interest rates:** higher interest rates result in lower owner-occupation, which in turn boosts rental demand
 - **Falling rents:** driven largely by long-term wage growth and less sensitive to interest rates and house prices

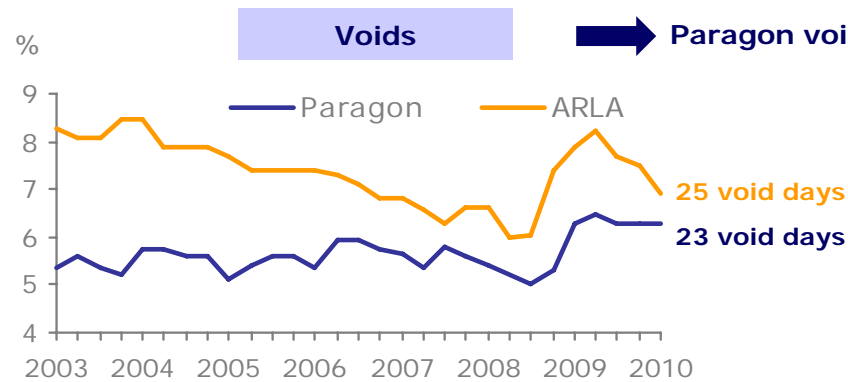
Flexible arrears management

- Receiver of Rent ("RoR") process established under Law of Property Act 1925
- Enables lenders to manage property and rental stream of defaulting customer, providing:
 - flexible exit strategy
 - time for borrower to resolve problem
 - protection for tenant
- Paragon has been a pioneer in the use of RoR in the buy-to-let market
 - Performance of loans handled by its own RoR team is superior to RoR loans managed by third parties

Attractive returns

“Residential market let investment has consistently rewarded investors with greater returns than commercial property and other asset classes since 2000 despite lower income returns. Long-term performance represents a hedge against inflation and volatility whilst maintaining impressive performance relative to other sectors.”

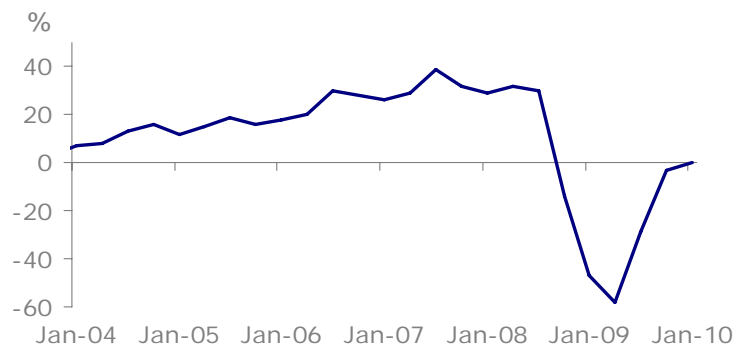
Investment Property Databank



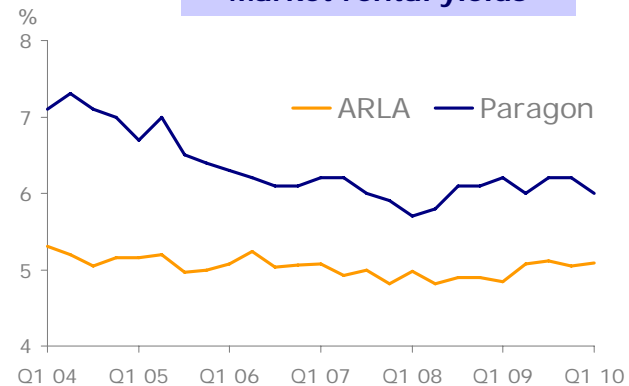
Paragon voids remain below industry average

- Yields fell gradually 2004 - 2008
- Stabilised during the market downturn
- Only measures yield on day one, takes no account of rental growth
- Accidental landlords exiting the market

Balance of surveyors reporting rise in rent expectations

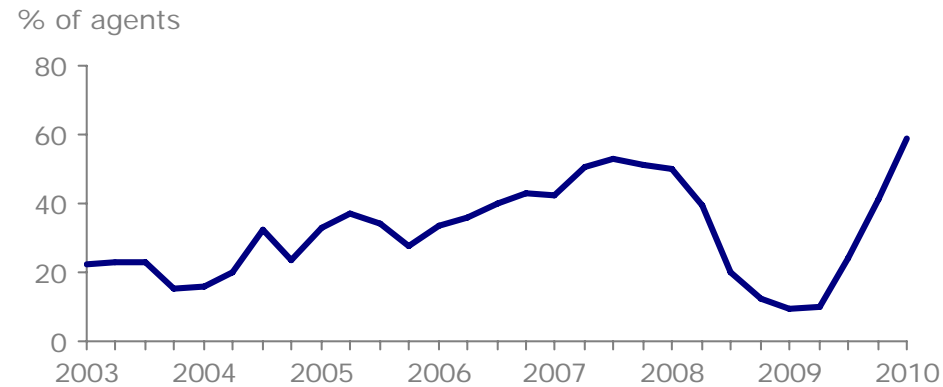


Market rental yields

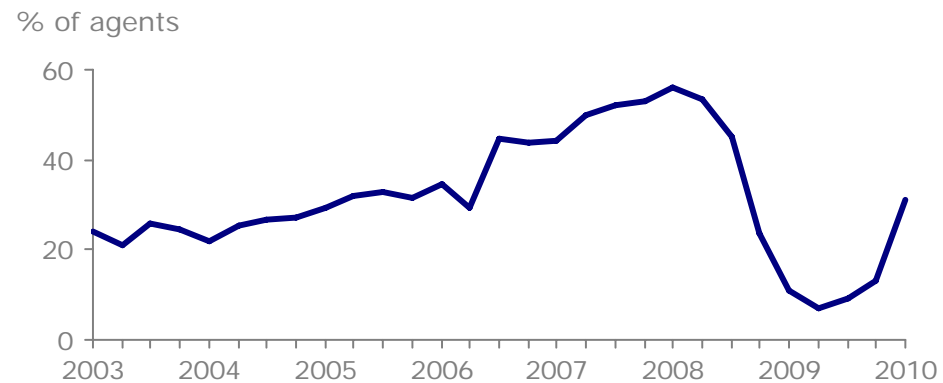


Balance of demand and supply

- 59% of ARLA agents reported that there are more tenants than properties in Q1:2010



- Proportion of ARLA agents reporting an increase in achievable rent levels has risen in Q1:2010



Buy-to-let overview

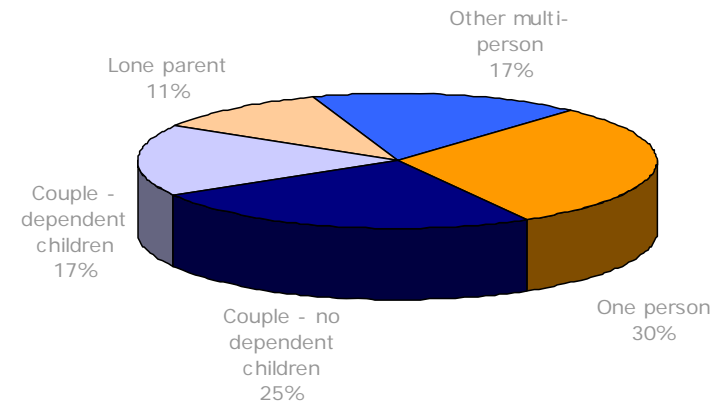
Tenants



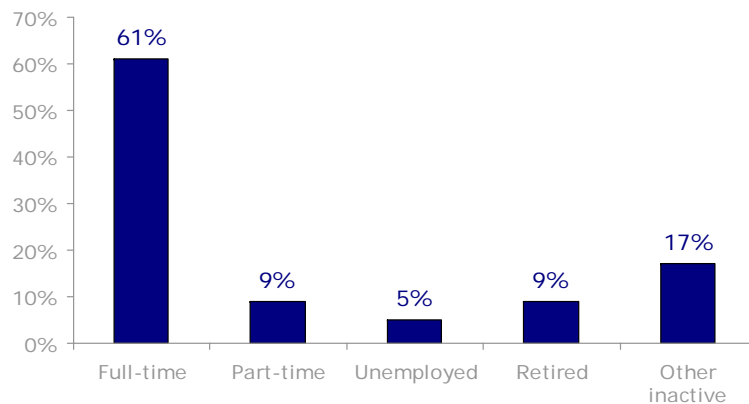
Tenant profile

- 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
 - 54% - between 25-44 years
 - 28% - over 45 years
- 20% of private renters in England received housing benefit in 2007

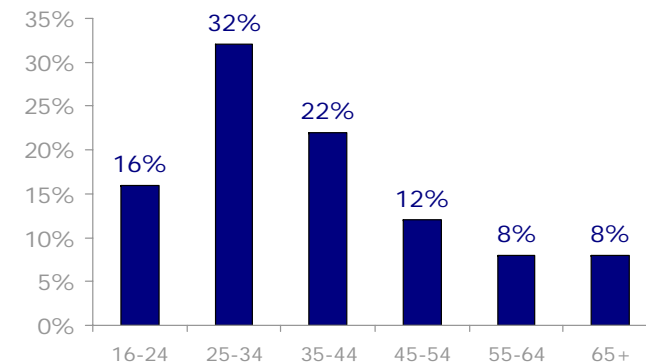
Household types in the PRS



Economic status of PRS tenants

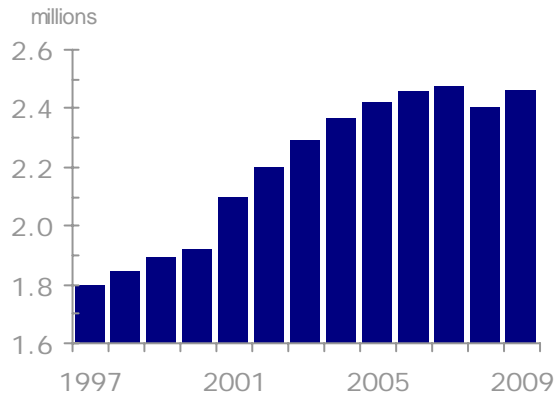


Age of PRS tenants



Tenant demand

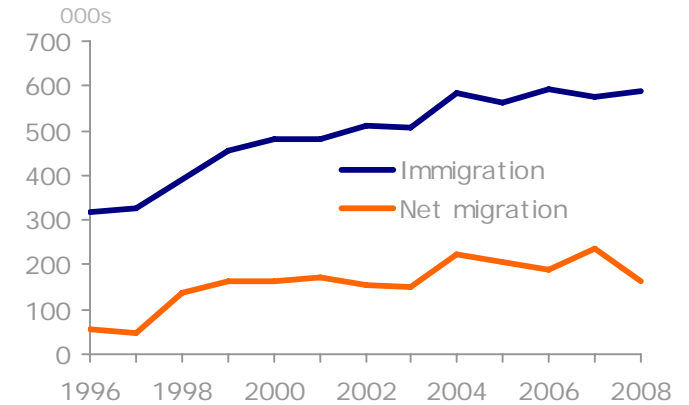
**Student numbers remain high
- UCAS applications up 23% YoY**



Source: Higher Education Statistics Agency

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

Immigration levels remain high

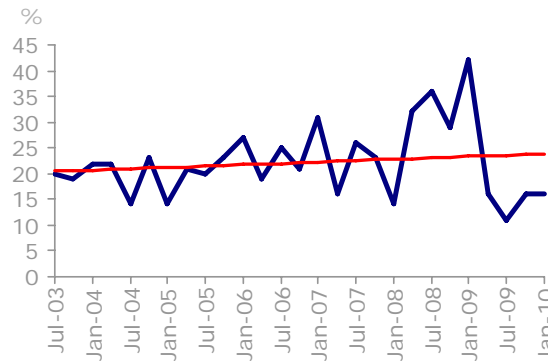


Source: Office for National Statistics

"Tenant demand for residential property picked up speed in 3 months to October. A net balance of 16% more surveyors reported a rise in new tenant lettings over this period compared with 11% in previous 3 months."

RICS Residential Lettings Survey November 2009

Balance of surveyors reporting a rise in tenant demand



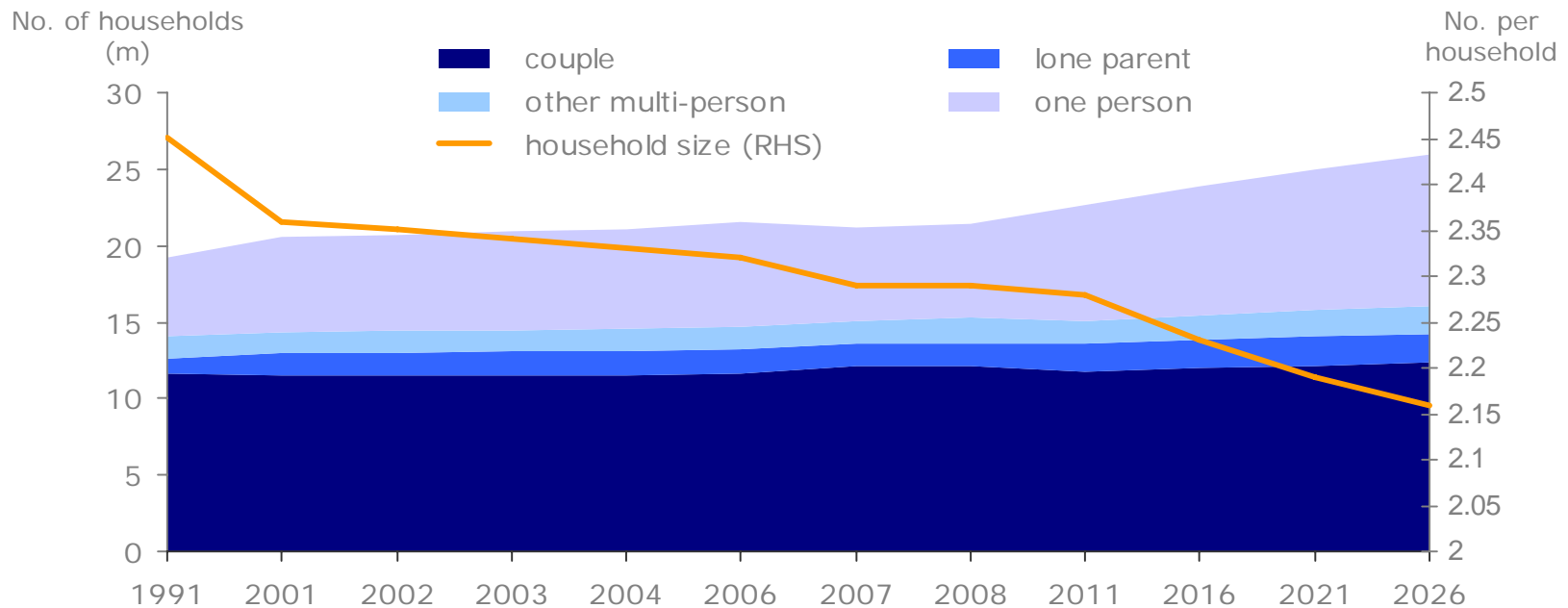
Source: RICS

"The PRS is a key component of the housing market in England. The flexibility of the PRS needs to be protected, and policy interventions should flow with the market rather than seek to change its essential characteristics."

Rugg Review of the Private Rented Sector

Rise of one-person households

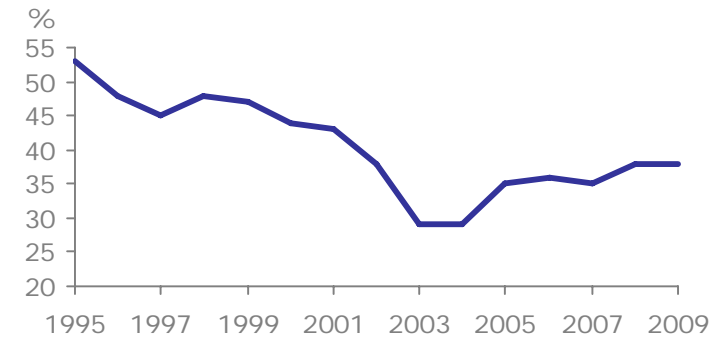
- There has been a significant increase in one-person households
 - 1971: 18%
 - 2008: 30%
- Implications for ability to afford to purchase property



Decline of first-time buyers

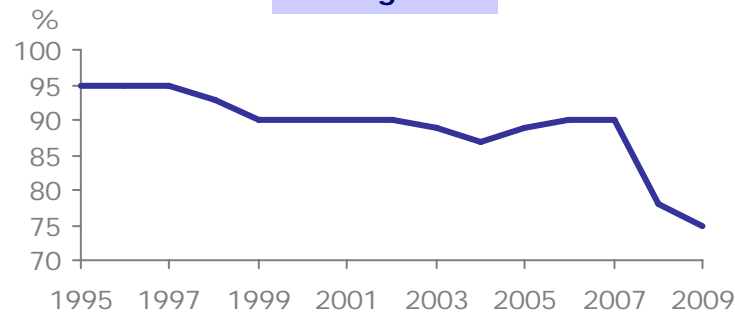
- Affordability constraints, lifestyle choices and rising student numbers are contributing
- First-time buyer (FTB) numbers in 2008 at a historic low, marginal increase in 2009
- Average age of unassisted FTB has risen from 33 before the credit crunch to 37 in 2009
- The average LTV for FTBs fell from 95% in 1994 to 75% in February 2010

First-time buyers as a % of all buyers

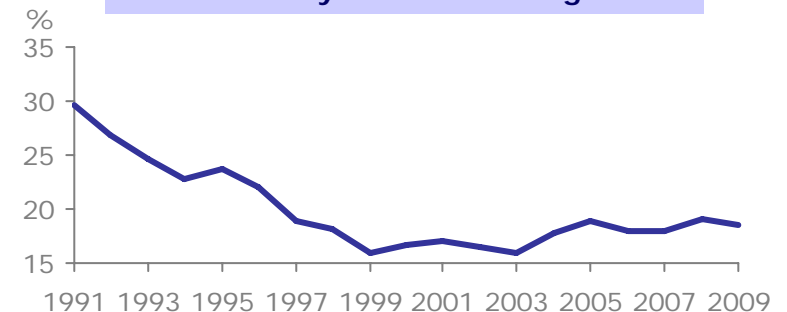


- First-time buyers as a proportion of all buyers has fallen from 55% in 1994 to 38% in 2009 - some recovery, but still historically low

Average LTV



First-time buyers under the age of 25



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

First-time buyer affordability

- Market conditions deteriorated for FTBs, with withdrawal 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

	April 2008	April 2010
Average house price	£178,555	£167,802
Average FTB LTV	89%	75%
Average deposit	£19,641	£41,951

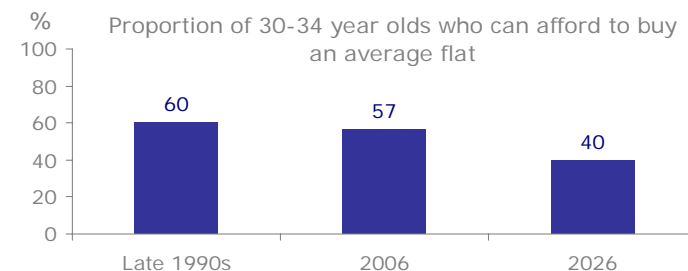
“Tighter lending criteria have clearly made it more difficult for first time buyers to enter the market.”

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

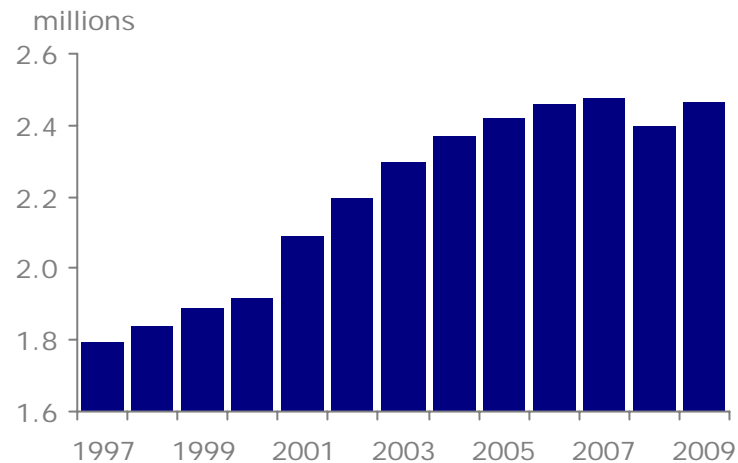


- Modelling by NHPAU shows that in late 1990s, 60% of 30-34 yr olds could afford to buy average flat
- By 2006, proportion was 57%
- In 2026, only 40% are expected to be able to buy

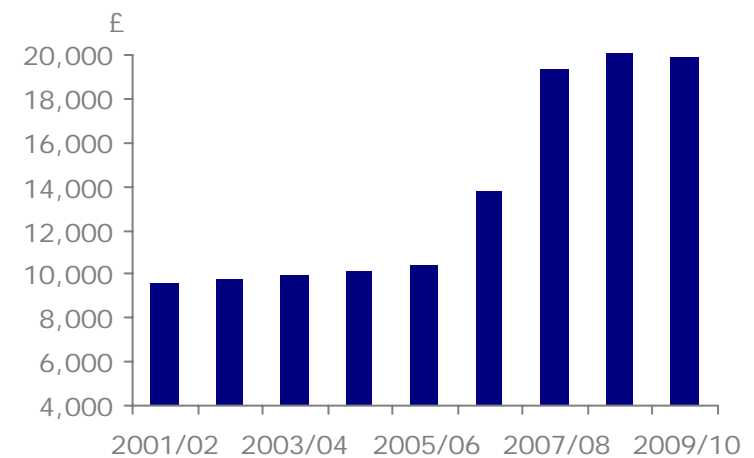
Rising student population and graduate debt

- Number of students in higher education up 30% over last decade
- University applications up 22.9% in 2010
- 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



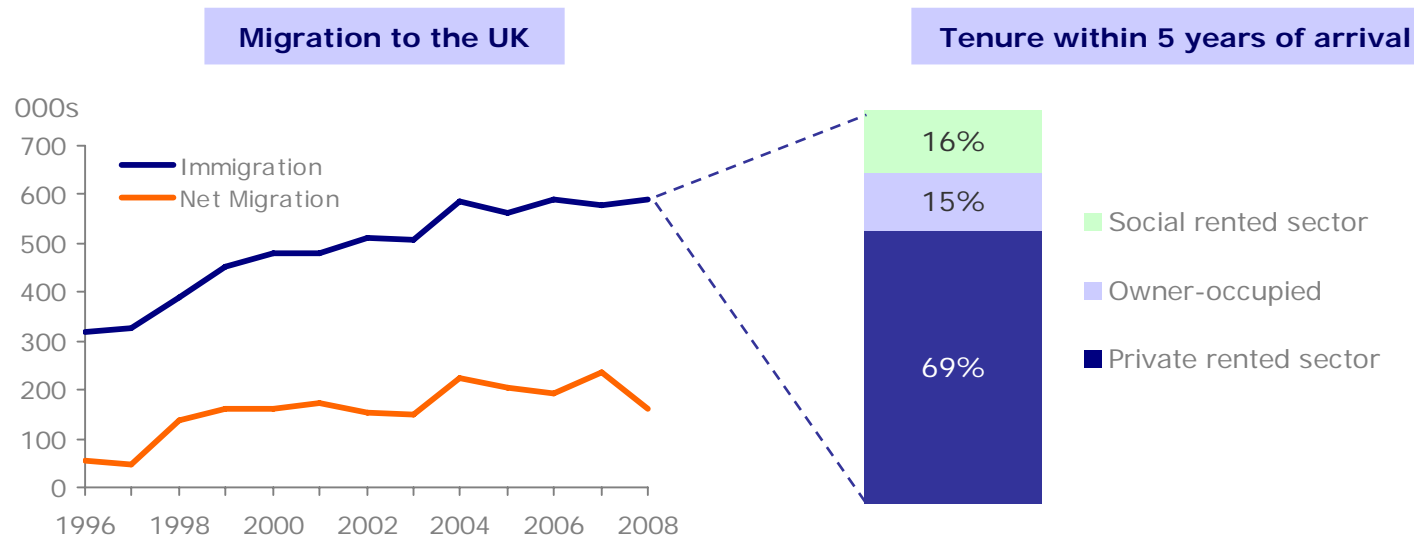
Inward migration

- In 2008, 590,000 people migrated into the UK, a small increase compared with 2007
- Net migration fell sharply however as emigration increased
- Levels still exceed pre-EU enlargement
 - 70% of landlords say that migrants from new EU member states have made an impact on the private rented sector
- 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 61.4 million to 71.6 million by 2033

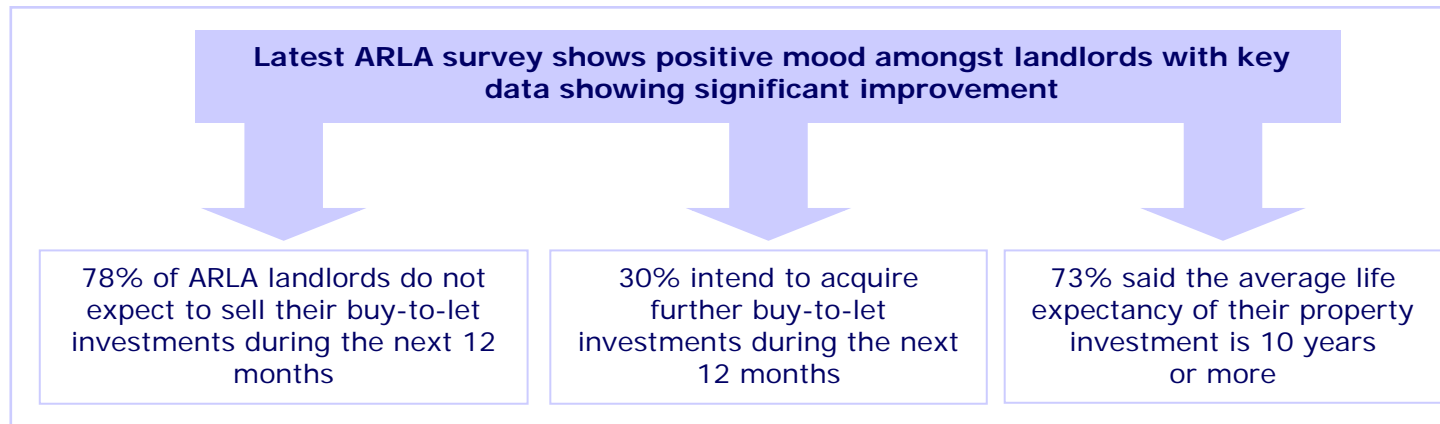


Buy-to-let overview

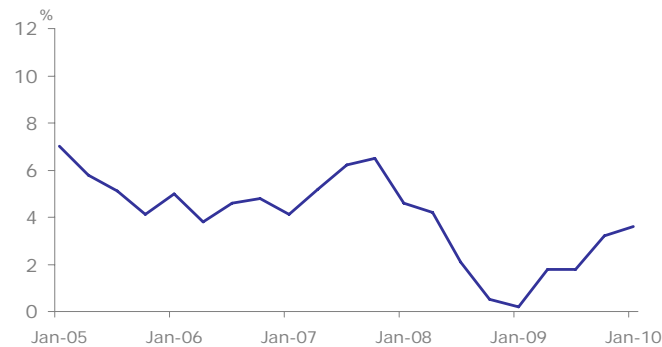
Landlords



Landlords committed to buy-to-let

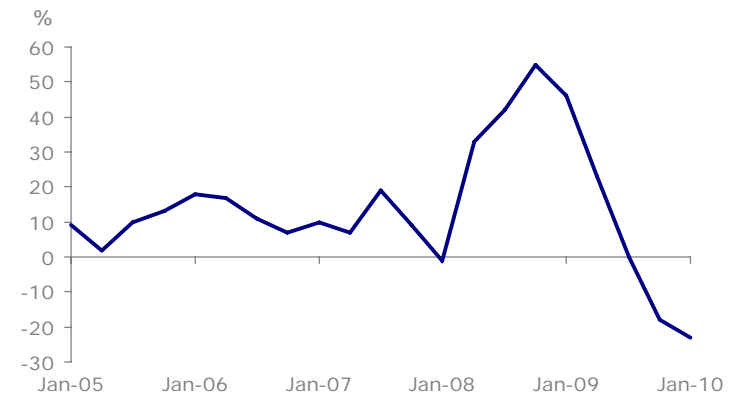


Landlord sales



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

Landlord instructions



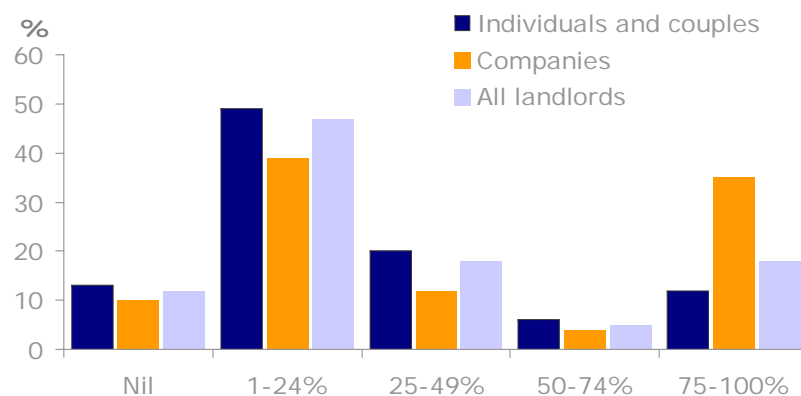
Decline in would-be sellers letting property has revealed the impact of lack of BTL financing on new supply

Amateurs or professional?

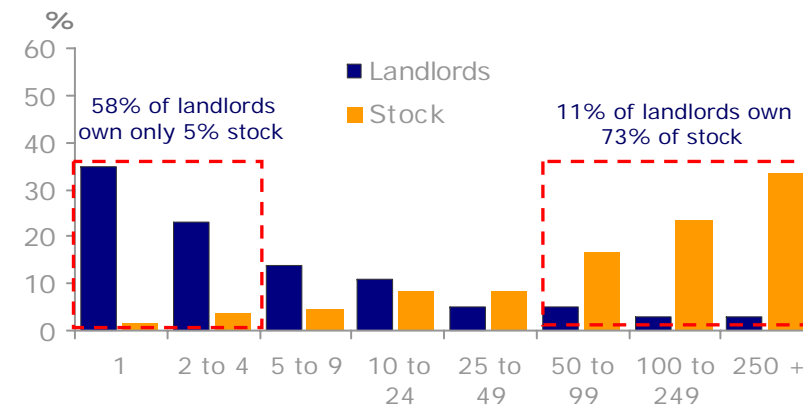
- CLG Private Landlords Survey shows that individual landlords typically derive up to a quarter of their income through rent
- Over two thirds of individuals and couples state that letting property is a secondary occupation

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

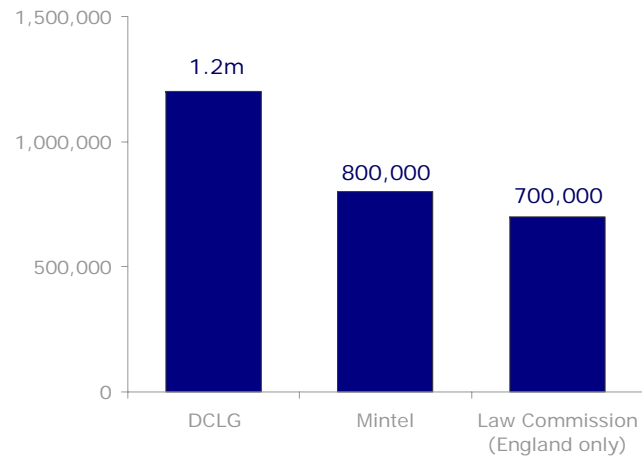


BTL stock predominantly held by professionals



How experienced are buy-to-let landlords?

Number of landlords in the UK



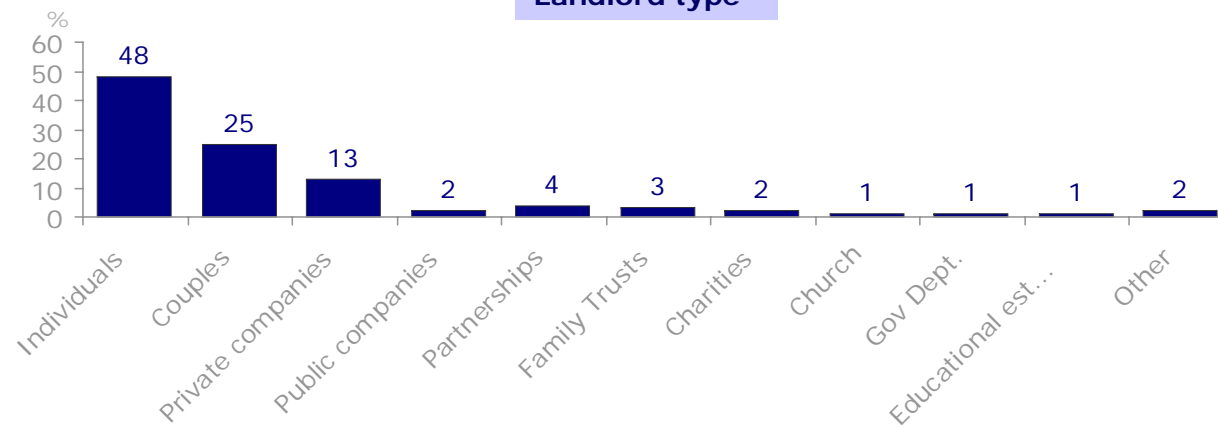
Length of time as a landlord

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

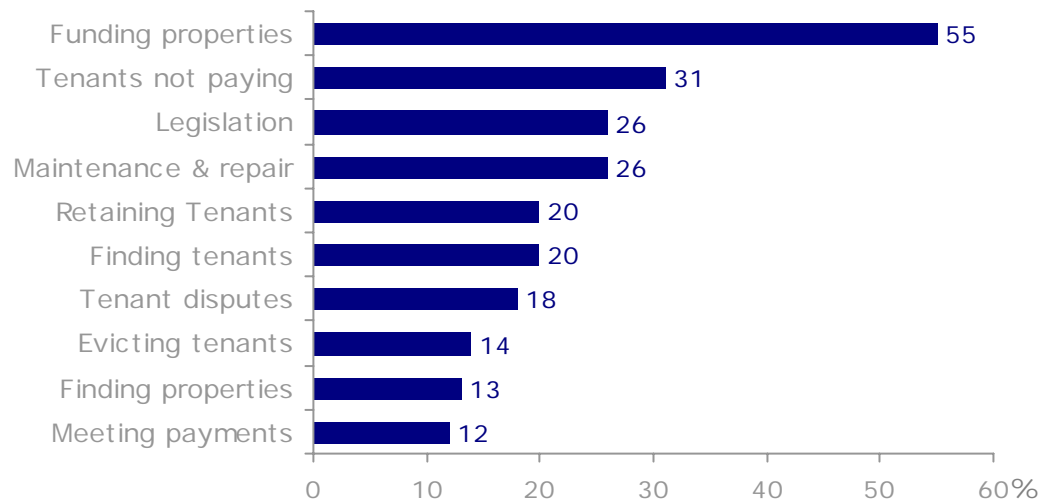
Landlord type



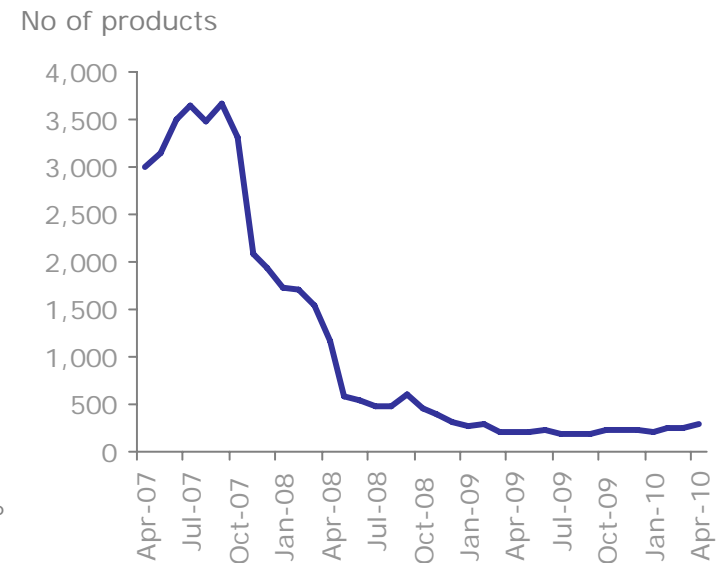
Issues for landlords

- Ability to meet tenant demand with supply of property, hampered by shortage of funding
- Risks being compounded by inappropriate regulation
- Already 50 Acts of Parliament and more than 70 sets of regulations governing the Private Rented Sector

Landlords' concerns



92% fall in BTL loan products since 2007



“The number of buy-to-let deals available has shrunk considerably since the credit crunch began”
Datamonitor

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