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# Fitch Upgrades 2 and Affirms 14 Tranches of 4 UK Prime RMBS

Link to Fitch Ratings' Report: Fitch Upgrades 2 and Affirms 14 Tranches of 4 UK Prime RMBS (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm? rpt\_id=877473&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzl1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VFJdGWGzv6v-UM)

Fitch Ratings-London-03 February 2016: Fitch Ratings has upgraded two and affirmed 14 tranches of four UK prime RMBS transactions: Brunel Residential Mortgages Securitisation No. 1 plc (Brunel), First Flexible No. 7 (FF7), Friary No. 1 Plc (Friary 1) and Friary No. 2 Plc (Friary 2). Nine tranches rated below 'AAAsf' have been removed from Rating Watch Positive. FF7's class C notes remain capped at the rating of the issuer account bank, Barclays (A/Stable/F1). A full list of rating actions is available at www.fitchratings.com or by clicking the link above.

The four portfolios comprise residential mortgages originated by Bank of Ireland (BoI) via its BoI UK and Bristol and West brands (Brunel), Paragon Group of Companies Plc (FF 7) and Principality Building Society (Friary).

### KEY RATING DRIVERS

Stable Performance in Brunel and Friary

Over the past 12 months, late-stage arrears (loans with payments overdue for more than three months) remained unchanged at 1.4% of the current portfolio balance in Brunel. As of December 2015, the same measure was reported at 0.9% (-13bps year-on-year (YoY) change) in Friary 1 and at 0.5% (+38bps YoY) in Friary 2. Fitch's UK Prime RMBS Index for late-stage arrears currently stands at 0.8% of the current outstanding balance. The cumulative balance of mortgages with properties taken into possession, expressed as a proportion of the original portfolio, is 0.2% and 0.04% in Friary 1 and Friary 2, respectively, while Brunel tracks the Fitch-index at 0.9%. These figures represent an increase of less than 10bps in all three deals, compared with 12 months ago.

Given the limited pipeline of late-stage arrears, Fitch expects possessions and associated losses to remain limited. This has resulted in the revision of the Outlook to Positive from Stable on Brunel's class C notes.

### Improving Performance in FF 7

Historically, FF 7 has been amongst the weaker performing UK prime transactions rated by Fitch. This is partially attributable to the high weighted average interest rate paid by the borrowers (4.7%) in the pool. Nevertheless, in more recent years the performance of the collateralised assets has shown a substantial improvement. Late-stage arrears, reported at 2.3% in December 2015, fell 4pp from their peak (6.3% in May 2013). Over the same period, cumulative possessions remained stable at 1.1% of the original collateral balance.

The continuous improvement in late-stage arrears and the stable levels of outstanding possessions drove the revision of the Outlook on the 'AAsf'-rated class B notes to Positive from Stable.

### Interest Rate Risk

After the initial discount period, the loans in the two Friary portfolios will fully revert to Principality Building Society's standard variable rate (SVR; 4.99%). In its analysis, Fitch assumed that 100% of the mortgages have already reverted to the SVR.

The interest rate risk mismatch between the SVR received on the mortgages and the Libor payable to the noteholders in not hedged in Friary 2 and FF7. The agency modelled the excess spread compression assuming a long-term SVR equal to Libor plus 255bps for Friary 2 and Libor plus 260bps for FF7. Also, as 23.6% of FF7's portfolio is linked to the Bank of England Base Rate (BBR), as per its criteria, Fitch applied a haircut on the BBR loans' spreads of 100bps to 200bps for the first year (depending on the rating scenario) and a lower haircut of 50bps thereafter.

Brunel and Friary 1 have swaps in place to hedge the mismatch arising from the interest paid on the securitised mortgages and the three-month Libor payable to the noteholders. However, Fitch deems the SVR swaps as difficult to replace, should the relevant institutions lose their eligibility as derivative support counterparties. Consequently, the agency has modelled the excess spread compression assuming a long-term SVR equal to the Libor rate plus 225bps and 255bps in Brunel and Friary 1, respectively.

As reflected in the rating actions, credit enhancement is sufficient to absorb these stresses.

## Payment Interruption Risk Mitigated

Fitch tested the ability of the structures to cope with the loss of the servicer. In Fitch's view, the presence of a back-up servicer in FF7, Friary 1 and Friary 2 (HML) limits the payment interruption risk to a single payment date. Since Brunel cannot rely on a back-up servicer, the notes are exposed to a possible cash flow interruption for two note payment dates. The cash provided by the reserve funds across all four transactions is considered sufficient to cover the risk of an interruption in payments of senior fees and notes' interests, under stressed Libor assumptions, for the periods tested.

# Commingling Exposure Mitigated

According to Fitch's criteria, the risk related to the default of the collection account banks is material in Brunel, Friary 1 and Friary 2. As a result, the credit enhancement available to the rated notes in these transactions has been reduced to account for a commingling loss equal to one month of interest and principal collections.

Nevertheless, Fitch considers credit enhancement sufficient to withstand all the stresses applied in the rating analysis, as reflected in the rating actions.

## RATING SENSITIVITIES

None of the four transactions features a liquidity facility/reserve solely dedicated to cover senior fees and interest shortfalls in case of servicer disruptions. Should the reserve funds be utilised towards clearing losses on properties sold, Fitch will re-assess their capacity to mitigate the payment interruption risk and may take actions accordingly.

In Fitch's view, a sudden sharp increase in interest rates would put a strain on borrower affordability and potentially lead to a rise in arrears and subsequent possessions. Should arrears and possessions exceed Fitch's current stresses, the agency may take negative rating action.

FF7's reserve fund is held with Barclays (A/Stable/F1). As the reserve fund is the sole form of credit support for the most junior, class C notes, their rating is linked to the bank's Long-term Issuer Default Rating.

## DUE DILIGENCE USAGE

No third party due diligence was provided or reviewed in relation to this rating action.

# DATA ADEQUACY

Fitch has checked the consistency and plausibility of the information it has received about the performance of the asset pools and the transactions. Fitch notes that information was missing on some of the loans in the pool-tapes received from the issuers: in all four transactions the issuers did not provide full information on primary and secondary income and employment type. Additionally, in Friary property and property valuation type was not provided on the totality of the loans. Fitch made the following assumptions to address the missing information: borrowers with no income provided were allocated to the highest debt-to-income band; borrowers with no employment status provided were assumed to be self-employed; unknown property types and property valuation types were allocated to the generic category 'Other'. Fitch has not reviewed the results of any third party assessment of the asset portfolio information or conducted a review of origination files as part of its ongoing monitoring.

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### Relevant to Brunel and FF7

Fitch did not undertake a review of the information provided about the underlying asset pools ahead of the transactions' initial closing. The subsequent performance of the transactions over the years is consistent with the agency's expectations given the operating environment and Fitch is therefore satisfied that the asset pool information relied upon for its initial rating analysis was adequately reliable.

### Relevant to Friary 1 and Friary 2

Prior to the transactions closing, Fitch reviewed the results of a third party assessment conducted on the asset portfolio information, which indicated no adverse findings material to the rating analysis.

Prior to the transactions closing, Fitch conducted a review of a small targeted sample of the PBS's origination files and found inconsistencies or missing data related to the property valuation. These findings were considered in this analysis by assuming a 5% haircut to the value of those properties associated with 'desktop' and 'other' property valuation types (Friary 1) and to newly built properties (properties built less than two years before the mortgage origination date) (Friary 2).

#### For all four transactions

Overall and together with the assumptions referred to above, Fitch's assessment of the information relied upon for the agency's rating analysis according to its applicable rating methodologies indicates that it is adequately reliable.

### SOURCES OF INFORMATION

The information below was used in the analysis.

Loan-by-loan data as at:

Brunel: 31 December 2015, provided by Bank of Ireland UK

- FF7: 30 November 2015, provided by Paragon
- Friary 1 and Friary 2: 30 September 2015, provided by PBS

### Transaction reporting as at:

- Brunel: 13 January 2016, provided by Bank of Ireland UK
- FF7: 22 December 2015, provided by Paragon
- Friary 1 and Friary 2: 21 January 2016, provided by PBS

### MODELS

The models below were used in the analysis. Click on the link for a description of the model.

ResiEMEA

ResiEMEA. (https://www.fitchratings.com/jsp/creditdesk/ToolsAndModels.faces?context=2&detail=135)

### EMEA RMBS Surveillance Model

EMEA RMBS Surveillance Model. (https://www.fitchratings.com/web\_content/pages/rmbs/emea-rmbs-surveillance-model.htm)

### REPRESENTATIONS AND WARRANTIES

A comparison of the transaction's Representations, Warranties & Enforcement Mechanisms to those typical for the asset class is available by accessing the appendix that accompanies the initial new issue report (see Friary No.1 plc - Appendix, dated 16 November 2011 and Friary No.2 plc - Appendix, dated 09 June 2014 at www.fitchratings.com). In addition refer to the special report "Representations, Warranties, and Enforcement Mechanisms in Global Structured Finance Transactions" dated 12 June 2015 available on the Fitch website.

## Contacts:

Lead Surveillance Analyst Alberto Tentori Analyst +44 20 3530 1735 Fitch Ratings Limited 30 North Colonnade London E14 5GN

Committee Chairperson Sanja Paic, CFA Senior Director +44 20 3530 1282

Media Relations: Athos Larkou, London, Tel: +44 203 530 1549. Email: athos.larkou@fitchratings.com.

Additional information is available at www.fitchratings.com.

## **Applicable Criteria**

Counterparty Criteria for Structured Finance and Covered Bonds (pub. 14 May 2014) (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm? rpt\_id=744158&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzl1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VłJdGWGzv6v-UM)

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum (pub. 14 May 2014)

(https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=744175&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzl1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VFJdGWGzv6v-UM)

Criteria Addendum: UK Residential Mortgage Assumptions (pub. 16 Dec 2015) (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=875200&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VI.ldGWGzv6v-UM)

Criteria for Rating Caps and Limitations in Global Structured Finance Transactions (pub. 28 May 2014)

(https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=748781&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzi1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VIJdGWGzv6v-UM)

Criteria for Sovereign Risk in Developed Markets for Structured Finance and Covered Bonds (pub. 20 Feb 2015)

(https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=862115&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzi1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VIJdGWGzv6v-UM)

EMEA RMBS Rating Criteria (pub. 16 Dec 2015) (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=875102&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzl1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VIJdGWGzv6v-UM)

Global Criteria for Lenders' Mortgage Insurance in RMBS (pub. 23 Jun 2015) (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=865195&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0ŃTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VIJdGWGzv6v-UM)

Global Structured Finance Rating Criteria (pub. 06 Jul 2015) (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=867952&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzl1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VFJdGWGzv6v-UM)

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### Related Research

Friary No. 2 plc - Appendix (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=750075&cff=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VI

Friary No.1 plc - Appendix (https://www.fitchratings.com/creditdesk/reports/report\_frame.cfm?

rpt\_id=656415&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzl1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VIJdGWGzv6v-UM)

### **Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press\_releases/content/ridf\_frame.cfm?
pr\_id=998975&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzl1NiJ9.eyJleHAiOjE0NTUxMzM2NDgsInNlc3Npb25LZXkiOiJMR0Y0QTBVRVVJUENRU1FCTExDRFVUR1Y5N1VHIdGWGzv6vJIM)

Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr\_id=998975)

Endorsement Policy (https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31)

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