PARAGON BANKING GROUP PLC
23 January 2018

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Trading update

Strong organic lending growth

Paragon Banking Group PLC ("the Group" or "Paragon") today publishes its trading update based upon the business performance from 1 October 2017 to 31 December 2017.

Highlights

- New lending up 65% compared to Q1 2017 at £469.8 million
- Increasing proportion of complex buy-to-let lending flows post PRA rule changes
- Deposit balances above £4 billion
- Continued strong credit performance

£ million	Q1 2017	Q1 2018	% change
Buy-to-let	185.2	342.9	*+85%*
Other mortgages	13.6	23.6	*+74%*
Total Mortgages	**198.8**	**366.5**	***+84%***
Asset finance	54.7	60.0	*+10%*
Development finance	10.1	14.4	*+43%*
Motor finance	20.7	28.9	*+40%*
Total Commercial Lending	**85.5**	**103.3**	***+21%***
Total new lending	**284.3**	**469.8**	***+65%***
Idem Capital	95.4	0.0	*-100%*
Total new lending and investment	**379.7**	**469.8**	***+24%***

Nigel Terrington, Chief Executive said:

"We have made excellent progress during the first quarter. The lending growth achieved across the Group has been outstanding and reflects the increasing strength of the franchise. Our retail deposit base continues to deepen, providing us with a stable platform for growth and the ability to optimise further the Group's funding structure. The organisational changes we completed last year, coupled with the growing demand and opportunity within specialist UK lending markets, will enable us to build on this momentum throughout the year."

Mortgages

Lending volumes in the overall buy-to-let market remain lower year on year despite increased levels of remortgage activity. The implementation in September 2017 of the PRA's requirements for the underwriting of more complex mortgage applications for portfolio landlords has resulted in a realignment of competition, with a number of mainstream lenders either exiting the complex segment of the market or offering only a limited proposition. Paragon's experience and capability is well aligned with these new requirements, allowing the Group to increase its share of more specialist portfolio landlord business.

The mix of Paragon's buy-to-let completions in the quarter was little changed from last year, with complex loans representing 66% of advances and simple completions comprising the balancing 34%. However, the impact of the PRA underwriting rule changes from September have had a more profound impact on application flows during the quarter. As a result, the mix in the pipeline at 31 December 2017 had moved to 79% complex and just 21% simple. The December pipeline rose from September's £604.2 million to £618.7 million.

Buy-to-let redemption levels remain high but fell from the peak levels seen in the summer quarter. The annualised redemption rate for the first quarter was 21% for the new book and 12% for the total portfolio.

Commercial Lending

Each of the three commercial lending product lines produced strong volume growth in the quarter, in line with expectations. In addition to sustained organic growth, the Group also acquired a specialist broker during December. Iceberg sources loans for mid-sized UK law firms to support the specific business costs of running a law practice, such as insurance and professional certification costs. It also provides loans to family law clients, financing legal costs for divorce and probate cases. The initial consideration for the purchase was £5.2 million, with a further £13.0 million to be paid, subject to meeting performance conditions, over the coming five years. Iceberg is based in Poole, Dorset and the highly regarded team brings extensive professional services funding experience to the Group.

Idem Capital

Our discipline over pricing and risk in a highly competitive market resulted in no new deals completing for Idem Capital during the quarter. However, the business continues to see a strong pipeline of opportunities but will maintain its discipline against this challenging market backdrop.

Funding update

Paragon's deposit raising maintained its strong progress during the quarter, with balances of £4.03 billion at the quarter end, up 98% from £2.03 billion at 31 December 2016. The average deposit cost for the portfolio remained flat in the period; however, the average cost of new deposits during the quarter was 5bp below that paid in the quarter to September 2017.

The Group made further drawings under the Term Funding Scheme during the quarter, with £869 million drawn at the quarter end. Further drawings are expected to be made in January and February 2018, at which point the scheme closes to new drawings.

During December, the Group exercised its call option on Paragon Mortgages (No.8) PLC, one of its legacy securitisation structures. The securitisation notes were refinanced using Paragon's retail deposit funding in mid-January 2018, releasing the vehicle's £19.0 million first loss reserve back to the Group.

Credit quality

The credit performance of the Group's portfolios remains strong, with continued low arrears on the buy-to-let portfolio and behavioural scores on the wider portfolio continuing the favourable themes seen in recent years.

Capital management

Paragon's capital position remains strong, with an unaudited CET1 ratio of 15.6% at 31 December 2017. The buy-back of up to £50 million for the year has commenced, with £5.0 million having been repurchased by the quarter end. During the period, the Basel Committee updated its approach to risk weighting assets under the Basel 3 regime. The proposals impact firms using the standardised approach and the internal ratings basis for assessing credit risk, the latter via the application of output floors. A phased implementation is planned between 1 January 2022 and 1 January 2027. With the Group's current mix of business, the new standardised approach would result in modest risk weight inflation at the 2022 implementation date; however, the Group remains on track to make its IRB application during 2019.

Outlook

The Group continues to see good progress in each of its business lines and continues to trade in line with expectations.

For further information, please contact:

Paragon Banking Group PLC
Nigel Terrington, Chief Executive
Richard Woodman, Chief Financial Officer

Tel: 0121 712 3161

Headland
Lucy Legh and Del Jones
paragon@headlandconsultancy.com

Tel: 020 3805 4822

Paragon will be releasing its half-year results for the six months to 31 March 2018 on Thursday 24 May 2018.