Company Registration No: 09580619

PARAGON SEVENTH FUNDING LIMITED

Report and Financial Statements

Year ended 30 September 2022

CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report and the Strategic Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Paragon Seventh Funding Limited ('the Company). These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as 'anticipate', 'estimate', 'expect', 'intend', 'will', 'project', 'plan', 'believe', 'target' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance but are not the exclusive means of identifying such statements. These have been made by the directors in good faith using information available up to the date on which they approved this report, and the Company undertakes no obligation to update or revise these forward-looking statements for any reason other than in accordance with its legal or regulatory obligations (including under the UK Market Abuse Regulation).

By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Company and depend upon circumstances that may or may not occur in the future that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. There are also a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, and the extent of their impact on overall demand for the Company's services and products; potential changes in dividend policy; changes in government policy and regulation (including the monetary, interest rate and other policies of central banks and other regulatory authorities in the principal markets in which the Company operates) and the consequences thereof; actions by the Company's competitors or counterparties; third party, fraud and reputational risks inherent in its operations; the UK's exit from the EU; unstable UK and global economic conditions and market volatility, including currency and interest rate fluctuations and inflation or deflation; the risk of a global economic downturn; acts of terrorism and other acts of hostility or war and responses to, and consequences of those acts; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions (including, without limitation, actions taken in support of managing and mitigating climate change and in supporting the global transition to net zero carbon emissions); societal shifts in customer financing and investment needs; and other risks inherent to the industries in which the Company operates.

Nothing in this Annual Report should be construed as a profit forecast.

STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

Paragon Seventh Funding Limited ('the Company') is a special purpose company established to act as a funding vehicle within Paragon Banking Group PLC ('the Group'). On 14 November 2018, the Company entered into a £200.0m sterling facility with Bank of America Merrill Lynch. The facility is secured over all the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. This was renewed for 12 months on 24 October 2019 and was increased to £400.0m and renewed for a further 18 month commitment on 25 September 2020. On 8 November 2021 revisions to the facility were agreed extending the commitment period for an initial 13-month period with the ability to extend monthly until a potential final maturity date of 24 November 2024. The maximum drawing was increased to £450.0m and the interest rate payable was transitioned to 0.5% above SONIA.

During the year the Company operated in the United Kingdom.

On 8 November 2021, the Company purchased £113,400,000 of mortgages from Paragon Bank PLC following a drawing and an increase in the facility.

On 27 January 2022 the Company purchased £2,011,000 of mortgage loans from Paragon Bank PLC and used the principal cash collected within the month to finance them.

On 25 February 2022, the Company purchased £88,700,000 of mortgages from Paragon Bank PLC following a drawing and an increase in the facility.

On 8 July 2022 the Company sold £131,700,000 of mortgage loans to Paragon Bank PLC and used the proceeds to decrease the facility.

On 17 August 2022 the Company purchased £145,700,000 of mortgage loans from Paragon Bank PLC and drew on the sterling credit facility.

On 28 September 2022 the Company sold £227,900,000 of mortgage loans to Paragon Bank PLC and used the proceeds to decrease the facility.

As shown in the Company's profit and loss account on page 14, the net interest income increased from £2,102,000 to £6,442,000. This was due to an increase of mortgage interest income as loans were purchased during the year. The profit after tax has increased from £90,000 to £11,362,000. This was due to the increase in interest income and a fair value gain of £13,761,000 (2021: £1,629,000).

The balance sheet on page 15 of the Financial Statements shows the Company's financial position at the year end. Net assets have increased due to the profit in the year. Loans to customers have decreased to £192,485,000 (2021: £229,261,000) due to the Company selling mortgage loans and repaid on the sterling credit facility, with the amount outstanding at 30 September 2022 being £170,000,000 (2021: £201,000,000).

No interim dividend was paid during the year. No final dividend is proposed.

The Company has entered into derivative contracts in order to provide an economic hedge against its exposure to fixed rate loans to customers. Although these instruments provide an economic hedge the prescriptive nature of the requirements of International Accounting Standard 39 – 'Financial Instruments: Recognition and Measurement' (IAS 39), means that hedge accounting cannot always be achieved. This has led to the Company recognising a fair value net gain of £13,761,000 (2021: £1,629,000) in the year due to the effectiveness of the hedge relationship. This represents a timing difference and cumulative gains and losses recognised will tend to zero over time.

The Group manages its operations on a centralised basis. For this reason, the Company's directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The performance of the Group's mortgage lending operation, which includes the Company, is discussed in the Annual Report of Paragon Banking Group PLC, which does not form part of this Report.

STRATEGIC REPORT (CONTINUED)

PRINCIPAL RISKS AND UNCERTAINTIES

The assets of the Company are located entirely in the United Kingdom and its results are therefore impacted by the economic environment within the UK. A material downturn in economic performance could increase the numbers of customers who default on loans and / or cause the values of the properties over which the Company enjoys security to fall.

The UK economy in the current year has been impacted by a number of significant pressures, initially the ongoing impacts of the Covid pandemic and latterly inflationary pressures, rising interest rates and geopolitical impacts resulting from Russian actions in Ukraine. These factors have caused major economic disruption within the UK and global economy with their ultimate impacts remaining uncertain, over both the short and longer terms.

The Company has established processes in place and proved on a through-the-cycle basis which will allow it to support its customers through any adverse economic conditions and optimise outcomes for both customers and investors.

The Company is a securitisation company and has been structured so as to avoid, in as far as is possible, all forms of financial risk with its outstanding loan notes match-funded to maturity. An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out in note 16, a discussion of critical accounting judgements is set out in note 19 and a discussion of critical accounting estimates is set out in note 20.

FUTURE PROSPECTS

After considering the above, the directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future, this is further discussed in note 18.

BOARD AND STAKEHOLDERS

The Board of the Company is mindful of its duty to promote the success of the Company for the benefit of its shareholders (insofar as this is applicable to the Company as a special purpose vehicle company) and to fulfil the Company's purpose, having regard to the interests of all of its stakeholders and, in particular, the interests of the Company's noteholders. The Board confirms that, for the year ended 30 September 2022, it has acted to promote the success of the Company for the benefit of its members as a whole and continues to have due regard to the following matters insofar as they are applicable (as per section 172 of the Companies Act 2006):

a. The likely consequences of any decision in the long-term
b. The interests of the Group's employees
c. The need to foster the Company's business relationships with suppliers, customers and others
d. The impact of the Company's operations on the community and the environment
e. The desirability of the Company maintaining a reputation for high standards of business conduct
f. The need to act fairly as between members of the Company

STRATEGIC REPORT (CONTINUED)

BOARD AND STAKEHOLDERS (CONTINUED)

As part of the Group, stakeholder engagement, for stakeholder groups where there is substantial common identity between the non-shareholder stakeholders of the Company and of the Group, takes place at a group level. The Company looks to group initiatives for guidance and takes them into account in its decision making. The Company follows group policies and procedures, including those relating to the fair treatment of customers, standards of business conduct, the environment, the community and other stakeholders, insofar as they are applicable to the Company. More detail may be found in the Paragon Banking Group PLC 2022 Annual Report and Accounts and its 2022 Responsible Business Report (available on the Paragon Banking Group PLC website).

In its decision making, the Board of Directors will also have regard to the rights and interests of the holders of the Mortgage Backed Floating Rate Notes in accordance with the transaction documents under which they were issued.

As a securitisation entity the decision-making powers of the Board of Directors are limited so long as the notes remain outstanding. Key policies have been predetermined at the time of issuance and the operational roles have been assigned to third parties with their roles strictly governed by the transaction documents.

However, in considering items of business the Board makes autonomous decisions on their own merits, with a view to promoting the long-term success of the Company, taking into account those factors set out in section 172 of the Companies Act 2006 insofar as they are relevant, and the stakeholders impacted by such decisions.

Board meetings are held periodically where the directors consider Company business, including its results and performance. As a special purpose funding vehicle for the Group, the Board also reviews strategy, financial and operational performance, as well as information covering areas such as key risks and legal and regulatory compliance. This information is presented to the Board through reports sent in advance of each Board meeting and through in person presentations.

More information on the Company’s impact on individual stakeholder groups is set out below.

SHAREHOLDERS

The Company has a single shareholder, Intertrust Corporate Services Limited which holds the entire share capital of the Company on a discretionary trust basis for the benefit of certain charities. However, the transaction documents limit this entity to a nominal interest in the risks and rewards of the business of the Company. Those risks and rewards attach to non-equity securities and fall to their holders which are companies within the Group.

ENVIRONMENT

The Group recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any impacts that might result from the Group’s activities. The Company operates in accordance with group policies, which are described in the Paragon Banking Group PLC Annual Report, which does not form part of this Report. Further information can also be found in the Group’s 2022 Responsible Business Report (published on the Paragon Banking Group PLC website), which does not form part of this report.

STRATEGIC REPORT (CONTINUED)

EMPLOYEES

The Company has no employees. All operational services are provided by employees of the Group. The Group's employment policies are described in the Paragon Banking Group PLC Annual Report, with supplementary information included in the Group's 2022 Responsible Business Report, neither of which forms part of this report.

This Strategic Report has been drawn up and presented in accordance with, and in reliance upon, applicable English company law, in particular Chapter 4A of the Companies Act 2006, and the liabilities of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

Approved by the Board of Directors
and signed on behalf of the Board

HELENA WHITAKER

per pro Intertrust Directors 1 Limited

Director

27 January 2023

DIRECTORS' REPORT

The directors present their Annual Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the audited Financial Statements of Paragon Seventh Funding Limited, a company registered in England and Wales with registration no: 09580619, for the year ended 30 September 2022.

GOING CONCERN

After making enquiries, the directors believe that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

CORPORATE GOVERNANCE

The directors have been charged with governance in accordance with the transactional documentation detailing the mechanism and structure of the transaction. The structure of the Group is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned to third parties with their roles strictly governed by the transaction documents.

DIRECTORS

The directors during the year and subsequently were:

Intertrust Directors 2 Limited

Intertrust Directors 1 Limited

J P Giles

H Whitaker

DIRECTORS' INDEMNITIES

The Company has made qualifying third party indemnity provisions for the benefit of its directors which were made during the Year and remain in force at the date of this report.

AUDITOR

The directors have taken all necessary steps to make themselves and the Company's auditor aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditor is unaware.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 (2) of the Companies Act 2006.

No notice from members under section 488 of the Companies Act 2006 having been received, the directors intend that the auditor, KPMG LLP, shall be deemed to be reappointed in accordance with section 487(2) of the Act.

INFORMATION PRESENTED IN OTHER SECTIONS

Certain information required to be included in a directors' report by the Companies Act 2006 and regulations made there under can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

- Commentary on the likely future developments in the business of the Company is included in the Strategic Report
- A description of the Company's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 16 to the accounts
- Disclosure on any dividends paid during the year is included in the Strategic Report

DIRECTORS' REPORT (CONTINUED)

Approved by the Board of Directors
and signed on behalf of the Board

HELENA WHITAKER

per pro Intertrust Directors 1 Limited

Director

27 January 2023

Registered Office: 51 Homer Road, Solihull, West Midlands, B91 3QJ

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT, THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Annual Report and the Company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company's profit or loss for that period. In preparing each of the Company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable, relevant and reliable
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report and Directors' Report that complies with that law and those regulations.

Responsibility statement of the directors in respect of the annual financial report

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole

- the strategic report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT, THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS (CONTINUED)

We consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

Approved by the Board of Directors and signed on behalf of the Board.

HELENA WHITAKER

per pro Intertrust Directors 1 Limited

Director

27 January 2023

Opinion

We have audited the Financial Statements of Paragon Seventh Funding Limited year ended 30 September 2022 which comprise the profit and loss account, the balance sheet, the statement of movement in equity and the related notes 1 to 21, including the accounting policies in note 18.

In our opinion the Financial Statements:

- give a true and fair view of the state of the company's affairs as at 30 September 2022 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

In our evaluation of the directors' conclusions, we considered the inherent risks to the Company's business model and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Company will continue in operation.

Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

- To identify risks of material misstatement due to fraud ('fraud risks') we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Our risk assessment procedures included:

- Enquiring of directors, Internal Audit and inspection of policy documentation as to the high-level policies and procedures of the Paragon Group (of which this company is a part) to prevent and detect fraud, including the Internal Audit function, and the Company's channel for 'whistleblowing', as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Reading Board, Audit Committee and Risk Committee minutes.
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls and the risk of fraudulent revenue recognition, in particular the risk that the Company management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements.

On this audit we do not believe there is a fraud risk related to revenue recognition, with the exception of the EIR adjustment. The revenue streams are considered non-complex and require limited judgement. However, we have recognised a fraud risk in respect of the EIR adjustment to interest income given the subjectivity inherent in the estimate.

We also identified a fraud risk related to estimation of impairment provisions on loans to customers, specifically relating to the significant estimation uncertainty inherent in the subjective judgements or uncertainties that are difficult to corroborate.

We also performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted and approved by the same user and those including specific descriptors.
- Assessing whether the judgements made in making accounting estimates are indicative of a potential bias.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably. Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies' legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Company's license to operate. We identified the following areas as those most likely to have such an effect: money laundering, financial crime, certain aspects of company legislation recognising the financial nature of the Company's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore, if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

Strategic report and directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 8 the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Michael Davidson (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

1 Sovereign Square

Sovereign Street

Leeds

LS1 4DA

27 January 2023

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2022

	Note	2022 £000	2021 £000
Interest receivable and similar income	2	13,141	4,490
Interest payable and similar charges	3	(6,699)	(2,388)
Net interest income		6,442	2,102
Other operating income		29	3
Total operating income		6,471	2,105
Operating expenses		(4,950)	(3,604)
Provision for losses		(28)	(40)
Fair value gain	5	13,761	1,629
Operating profit, being profit on ordinary activities before taxation	6	15,254	90
Tax on profit on ordinary activities	7	(3,892)	-
Profit on ordinary activities after taxation		11,362	90

Interest receivable arises from financial assets held at amortised cost.

There are no recognised gains or losses other than the profit for the current and the preceding years, and consequently a separate statement of comprehensive income has not been presented.

BALANCE SHEET

30 SEPTEMBER 2022

	Note	2022 £000	2022 £000	2021 £000	2021 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Financial assets	8		208,401		230,784
CURRENT ASSETS					
Debtors falling due with one year	11	263		169	
Cash at bank		31,526		14,464	
			31,789		14,633
			240,190		245,417
FINANCED BY					
EQUITY SHAREHOLDERS' FUNDS					
Called up share capital	12	-		-	
Profit and loss account		11,363		1	
			11,363		1
PROVISIONS FOR LIABILITIES	13		3,892		-
CREDITORS					
Amounts falling due within one year	14	28,363		9,503	
Amounts falling due after more than one year	14	196,572		235,913	
			224,935		245,416
			240,190		245,417

These financial statements of the Company (registered number 09580619) were approved by the Board of Directors 27 January 2023.

Signed on behalf of the Board of Directors

HELENA WHITAKER

per pro Intertrust Directors 1 Limited

Director

STATEMENT OF MOVEMENT IN EQUITY

YEAR ENDED 30 SEPTEMBER 2022

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	11,362	11,362
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	11,362	11,362
Opening equity	-	1	1
Closing equity	-	11,363	11,363

YEAR ENDED 30 SEPTEMBER 2021

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	90	90
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	90	90
Opening equity	-	(89)	(89)
Closing equity	-	1	1

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2022

1. GENERAL INFORMATION

Paragon Seventh Funding Limited ('the Company') is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 09580619. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Company's operations and its principal activities are set out in the Strategic Report.

These financial statements are presented in pounds sterling, which is the currency of the economic environment in which the Company operates

The remaining notes to the accounts are organised into three sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Financial Risk – providing information on the Company's management of its principal financial risks
- Basis of preparation – providing details of the Company's accounting policies and of how they have been applied in the preparation of the financial statements

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Company.

2. INTEREST RECEIVABLE AND SIMILAR INCOME

The Company has reconsidered the analysis it presents of net interest income in its accounts in light of the increasing magnitude of hedging impacts on these balances, with derivative income and expense attributed to the hedged transaction and shown separately. This will provide better information to users and is consistent with approaches currently used by comparable firms. Information in respect of the year ended 30 September 2021 has been restated on the same basis. While this change affects the total reported amounts of interest receivable and interest payable (note 3), total net interest is unaffected.

Interest receivable is analysed as follows.

	2022 £000	2021 £000
Interest on loans to customers	11,933	4,602
Effect of fair value hedging of loan assets	1,051	(218)
Interest on loans to customers after hedging	12,984	4,384
Interest receivable from related parties	-	106
Interest on deposits	157	-
	13,141	4,490

The above amounts relate to:

	2022 £000	2021 £000
Financial assets held at amortised cost	12,090	4,708
Derivative financial instruments held at fair value	1,051	(218)
	13,141	4,490

3. INTEREST PAYABLE AND SIMILAR CHARGES

The Company's interest payable disclosure has been reanalysed, and comparative amounts restated and described in note 2.

	2022 £000	2021 £000
Mortgage backed bank loans	3,945	696
Subordinated loan interest	2,394	805
Commitment fee	282	887
Interest payable to group companies	78	-
	6,699	2,388

All interest payable on financial liabilities relates to financial liabilities held at amortised cost.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

4. DIRECTORS AND EMPLOYEES

Directors' fees from the Company during the current year preceding period is listed in note 6.

The Company had no employees in the current year. All administration is performed by employees of related companies under the servicing agreement described in note 15. One director of the Company is employed by Paragon Finance PLC, a related party, and their remuneration is disclosed within the financial statements of that company, which do not form part of this Report.

5. FAIR VALUE NET GAIN

The fair value net gain of £13,761,000 (2021: £1,629,000) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting effectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The gain is primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities.

6. OPERATING PROFIT, BEING PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2022 £000	2021 £000
Operating profit is after charging:		
Directors' fees - Intertrust	13	6
Auditor remuneration - audit services	14	12
Deferred purchase consideration	3,847	3,222

Non audit fees provided to the Group are disclosed in the accounts of Paragon Banking Group Plc and the exemption from disclosure of fees payable to the Company's auditor in respect to non-audit services in these Financial Statements has been taken.

7. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge for the year

	2022 £000	2021 £000
Current tax		
Corporation tax	-	-
Deferred tax (note 13)		
Origination and reversal of timing differences	2,958	-
Rate change	934	-
	3,892	-
Tax charge on profit on ordinary activities	3,892	-

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

7. TAX ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

b) Factors affecting the tax charge for the year

	2022 £000	2021 £000
Profit before tax	15,254	90
UK corporation tax at 19% (2021: 19%) based on the profit for the year	2,898	17
Effects of:		
Utilisation of losses	60	(17)
Change in tax rate	934	-
Tax charge for the year	3,892	-

The standard rate of corporation tax in the UK applicable to the Company in the period was 19.0% (2021: 19.0%), based on currently enacted legislation. During the previous period, legislation was substantively enacted, that will increase the rate to 25% with effect from 1 April 2023. Consequently, temporary differences at the balance sheet date will either reverse at 22% in the year ended 30 September 2023 or 25% in subsequent years.

8. FINANCIAL ASSETS

	2022 £000	2021 £000
Loans to customers	192,485	229,253
Derivative financial assets (note 10)	15,916	1,531
	208,401	230,784

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

This note sets out information on the Company's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 8, loans held at amortised cost, accounted for under IFRS 9, subject to the IFRS 9 impairment requirements.

The disclosures are set out under the following headings:

- Basis of provision
- Impairments by stage and division
- Movements in impairment provision in the period
- Impairments charged to income

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Basis of provision

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. Provision may be based on either twelve month or lifetime ECL, dependant on whether an account has experienced a significant increase in credit risk ('SICR').

The Company's process for determining its provisions for impairments is summarised below. This includes:

- The methods used for the calculation of ECL
- How it defines SICR
- How it defines default
- How it identifies which loans are credit impaired, as defined by IFRS 9
- How the ECL estimation process is monitored and controlled
- How the Group develops and enhances the models it uses in the ECL estimation process
- How the Group uses judgemental adjustments to ensure all elements of credit risk are fully addressed

Calculation of expected credit loss ('ECL')

For the majority of the Company's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components. In determining for which portfolios a statistically modelled approach is appropriate, the Company considers the volume of available data and the level of similarity of the credit characteristics of the underlying accounts.

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Company's loan book. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The structure of the models was derived through analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. PD measures are calculated for the full contractual lives of loans with the models deriving probabilities that, at a given future date, a loan will be in default, performing or closed.The Company utilised all reasonably available information in its possession for this exercise.

LGD for each account is derived by calculating a value for exposure at the point of default (which will include consideration of future interest, account charges and receipts) and reducing this for security values and costs of recovery. These calculations allow for the Company's potential case management activities. This evaluation includes the potential impact of economic conditions at the time of any future default or enforcement. The derivation of the significant assumptions used in these calculations is discussed below.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Calculation of expected credit loss ('ECL') (continued)

Notwithstanding the mechanical procedures discussed above, the Company will always consider whether the process generates sufficient provision for particular loans, especially large exposures, and will provide additional amounts as appropriate.

In extreme or unprecedented economic conditions, such as the Covid pandemic, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of present conditions. In these circumstances, management carefully review all outputs to ensure provision is adequate.

At 30 September 2022 the UK economy was subject to levels of inflation and interest rates not seen for some considerable time and not represented sufficiently in the data sets used to create the Group's models. There was also a level of uncertainty as to the direction of government policy which was unusual for the UK. The situation was evolving rapidly at the year end, meaning that there was a risk that credit metrics and external credit bureau data might not fully reflect increasing risks, which would lead to a potential understatement of PDs.

During 2021 the management concluded that Group's models do not fully represent loss expectations, and Post Model Adjustments ('PMA's) have been made to compensate for these weaknesses. However, for the year ending 30 September 2022 no model adjustments are required.

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Company's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Company assesses SICR primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as an SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Company's hands concerning the customers present credit position is included in the evaluation, as well as the impact of future economic expectations.

As part of its determination of whether model outputs form a reliable basis for impairment provisioning, the Company considered whether it had any evidence of groups of accounts demonstrating factors indicating a higher level of credit risk than other accounts in the same portfolios. No such evidence was noted at 30 September 2022, and hence no additional accounts were identified as having an SICR.

While no requirement to identify additional SICR cases has arisen in 2022, the approach is consistent with that adopted at 30 September 2021, and will be kept under review in future periods.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The analysis of these default cases provides the foundation for the Company's PD modelling. IFRS 9 provides a rebuttable presumption that an account is in default when it is 90 days overdue and this was used as the basis of the Company's definition, combined with qualitative and quantitative factors specific to each portfolio.

The most influential quantitative factor in the majority of portfolios is the arrears level, while the principal qualitative factors relate to internal account management statuses. In particular the decision to commence a process of enforcement will be considered as a default in all portfolios. In the Company's buy-to-let mortgage portfolio the appointment of a receiver of rent to manage the property on the customers behalf is considered a default, while for portfolios assessed on a case-by-case basis, such as the Company's development finance loans, the movement of an account to the highest risk category is considered as a default.

This ensures that Company's definitions of default for its various portfolios are materially aligned to the regulatory definitions of default used internally, and are broadly aligned to its internal operational procedures, allowing for the arbitrary nature of the 90-day cut-off, which is a regulatory rather than an operational requirement. In particular the Company's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

Credit Impaired loans

IFRS 9 defines a credit impaired account as one where an account has suffered one or more event which has had a detrimental effect on future cash flows. It is thus a back-ward looking definition, rather than one based on future expectations.

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

All loans which are in the process of enforcement, from the point where this becomes the administration strategy, are classified as credit impaired.

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether an SICR trigger remains.

All default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than 90 days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

In order to provide better information for users, additional analysis of credit impaired accounts has been presented below distinguishing between probationary accounts, receiver of rent accounts, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired. While other indicators of default are in use, the categories shown account for the overwhelming majority of Stage 3 cases.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Monitoring of ECL estimation processes

The Group's ECL models are compiled on the basis of the analysis of relevant historical data. Before a model is adopted for use its operations and outputs are examined to ensure that it is expected to be appropriately predictive and, if it is an updated model, expected to be more predictive than any existing model. Before a new model is adopted the changes and impacts will be considered by the CFO, alongside any advice from the Group's independent model review functions.

The performance of all models is reviewed on an ongoing basis, by senior finance and risk management, including the CFO. Monitoring packs comparing actual and predicted loss levels are produced at regular intervals, set on the basis of the materiality of each model. The continuing appropriateness of model assumptions is also reviewed as part of this process.

Models are revisited on a regular basis to ensure that they continue to reflect the most recent data as the available information increases over time.

On a monthly basis all model outputs are reviewed by senior finance management including the CFO in conjunction with the latest credit risk operational and economic metrics to ensure that the impairment provision by assets type remains appropriate. This exercise will be the subject of particular focus at year end and half year.

This information is summarised for the Group Audit Committee on a biannual basis, and they have regard to this data in forming their conclusions on the appropriateness of provisioning levels.

Model development

The models used by the Group are updated from time to time to allow for changes in the business, developments in best practice and the availability of additional data with the passing of time. During the year ended 30 September 2021 a major update to the buy-to-let PD model took place.

The adoption of this model has enabled the reporting process in the year to be more streamlined and supported increased use of scenario analysis.

The Group's programme of model development continued during the year with a particular focus on analysing how default and loss data recorded over the period of the Coved pandemic should be reflected in forward-looking models, given the unprecedented nature of the pandemic and the national and international response to it.

All revised models and model enhancements are carefully reviewed and tested before adoption, and are subject to a governance process for their approval.

The impacts of the adoption of the new PD model on the calculated provision were not significant.

Judgemental adjustments

In order to ensure that its loan portfolios are adequately provisioned, the Group considers whether there are factors not fully captured by the modelling process, including economic conditions more generally, which indicate a need for judgemental adjustments. Information considered includes credit data, customer and broker feedback received, the results of insight surveys, industry intelligence and expert knowledge within the business lines.

During the year, the dominance of Covid in these considerations reduced as the short-term impact of the pandemic receded and other economic factors such as the UK cost of living, rising interest rates and the conflict in the Ukraine became more significant.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Judgemental adjustments (continued)

Towards the end of the year the consensus view of the likely severity of these impacts became markedly more pessimistic, and together with political instability in the UK Government and emerging negative economic indicators this generated a situation where very careful assessment of credit prospects was required.

Where management has identified a requirement to amend the calculated provision as a result of either model deficiencies or idiosyncratic behaviour in part of the portfolio, judgemental adjustments are applied to the modelled outputs so that the ECL recognised corresponds to expert judgement, taking into account the widest possible range of current information, which might not be factored into the modelling process.

In normal circumstances the Group's objective is to develop its modelling to the point where the level of judgemental adjustments required is minimal, but in economic conditions where previous relevant experience is limited or non-existent, some form of judgemental adjustment is always likely to be necessary. While high interest rate and inflation scenarios have occurred in the UK in the past, market conditions, products and regulatory expectations have moved on considerably in the meantime, and most such observations would pre-date the existence of buy-to-let mortgages as a distinct asset class. This means that the value of past history as a guide to future credit performance is reduced.

The current model behaviour and the potential for unobserved credit issues have meant that the requirement for such adjustments over recent periods has been significant. Evidence considered by management included internal performance data, customer feedback, evidence on the wider economy and quantitative and qualitative data and statements from industry, government and regulatory bodies. These are combined to form a broad estimate of the level of provision required across the Group.

Following a review of the mortgage portfolio, it was concluded that the models provided a sufficient level of provisioning of the classes of loans held, as a consequence no adjustments were posted in the current year.

The Company will continue to monitor the requirement for these adjustments as the economic situation develops and its impacts begin to be reflected in model outputs.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Impairments by Stage

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will also be made on the basis of ECLs

An analysis of the Company's loan portfolios between the stages defined above is set out below.

	Stage 1	Stage 2 *	Stage 3	Total
	£000	£000	£000	£000
30 September 2022				
Gross loan book	162,936	29,600	-	192,536
Impairment provision	(1)	(50)	-	(51)
Net loan book	162,935	29,550	-	192,485
Coverage ratio	0.00%	0.17%	0.00%	0.03%

	Stage 1	Stage 2 *	Stage 3	Total
	£000	£000	£000	£000
30 September 2021				
Gross loan book	219,180	10,113	-	229,293
Impairment provision	(11)	(29)	-	(40)
Net loan book	219,169	10,084	-	229,253
Coverage ratio	0.01%	0.29%	0.00%	0.02%

* Stage 2 balances are analysed in more detail below.

In terms of the Company's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Analysis of Stage 2 loans

The table below analyses the accounts in Stage 2 between those not more than one month in arrears where an SICR has nonetheless been identified from other information and accounts more than one month in arrears.

Cases which have been greater than one month in arrears in the last three months, but which are not at the balance sheet date are shown as 'recent arrears' in the tables below.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR. However, in certain loan portfolios, regular monthly payments of pre-set amounts are not required and hence this criterion cannot be used.

The value of accounts in stage 2 has increased across all categories as a result of the generally worsening economic outlook. The largest increase is in those cases in the buy-to-let book identified with an SICR through PD movements, a result of the updated economic scenarios and weightings.

Provision levels and coverage in the Mortgage Lending division have both reduced, however, due to the impact of the strong growth in house prices on security values.

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£000	£000	£000	£000
30 September 2022				
Gross loan book	-	29,600	-	29,600
Impairment provision	-	(50)	-	(50)
Net loan book	-	29,550	-	29,550
Coverage ratio	0.00%	0.17%	0.00%	0.17%
30 September 2021				
Gross loan book	-	10,113	-	10,113
Impairment provision	-	(29)	-	(29)
Net loan book	-	10,084	-	10,084
Coverage ratio	0.00%	0.29%	0.00%	0.29%

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Movements in impairment provision by stage

The movements in the impairment provision calculated under IFRS 9 is set out below.

	2022	2021
	£000	£000
At 1 October 2021	40	-
Assets purchased	7	-
Assets sold	(20)	-
Provided in period	24	40
Amounts written off	-	-
At 30 September 2022	51	40

Accounts are considered to be written off for accounting purposes when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions.

At 30 September 2022 enforceable contractual balances of £nil (2021: £nil) were outstanding on assets written off in the period. This will exclude those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances will be kept under review for operational purposes but no amounts will be recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

A more detailed analysis of these movements by IFRS 9 stage for the year ended 30 September 2022 and 30 September 2021 is set out below.

These tables, and the matching tables analysing movements in gross balances, have been compiled by comparing opening and closing balances on each account and analysing the movements between them.

Changes due to credit risk includes all changes in model parameters whether related to account performance, external credit data or model assumptions, including economic scenarios and weightings.

There have been no changes in models creating significant movements in balances in the period.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

A more detailed analysis of these movements by IFRS 9 stage for the year ended 30 September 2022 and 30 September 2021 is set out below.

	Stage 1	Stage 2 *	Stage 3 *	Total
	£000	£000	£000	£000
Loss allowance at 1 October 2021	11	29	-	40
New assets originated or purchased	7	-	-	7
Changes in loss allowance				
Transfer to stage 1	12	(12)	-	-
Transfer to stage 2	(4)	4	-	-
Transfer to stage 3	-	-	-	-
Changes on stage transfer	(12)	34	(14)	8
Changes due to credit risk	7	(5)	14	16
Assets derecognised	(20)	-	-	(20)
Write offs	-	-	-	-
Loss allowance at 30 September 2022	1	50	-	51
Loss allowance at 1 October 2020	-	-	-	-
New assets originated or purchased	64	-	-	64
Changes in loss allowance				
Transfer to stage 1	-	-	-	-
Transfer to stage 2	(29)	29	-	-
Transfer to stage 3	-	-	-	-
Changes on stage transfer	-	-	-	-
Changes due to credit risk	(24)	-	-	(24)
Write offs	-	-	-	-
Loss allowance at 30 September 2021	11	29	-	40

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1	Stage 2 *	Stage 3 *	Total
	£000	£000	£000	£000
Balances at 1 October 2021	219,180	10,113	-	229,293
New assets originated or purchased	315,423	35,116	-	350,539
Changes in staging				
Transfer to stage 1	4,922	(4,922)	-	-
Transfer to stage 2	(35,772)	35,772	-	-
Transfer to stage 3	(534)	(710)	1,244	-
Redemptions and repayments	(25,788)	(2,231)	(534)	(28,553)
Assets derecognised	(313,619)	(43,687)	(710)	(358,016)
Write offs	-	-	-	-
Other changes	(876)	149	-	(727)
Balance at 30 September 2022	162,936	29,600	-	192,536
Loss allowance	(1)	(50)	-	(51)
Carrying value	162,935	29,550	-	192,485
Balances at 1 October 2020	-	-	-	-
New assets originated or purchased	226,880	3,545	-	230,425
Changes in staging				
Transfer to stage 1	-	-	-	-
Transfer to stage 2	(6,499)	6,499	-	-
Transfer to stage 3	-	-	-	-
Redemptions and repayments	(2,641)	-	-	(2,641)
Assets derecognised	-	-	-	-
Write offs	-	-	-	-
Other changes	1,440	69	-	1,509
Balance at 30 September 2021	219,180	10,113	-	229,293
Loss allowance	(11)	(29)	-	(40)
Carrying value	219,169	10,084	-	229,253

Other changes includes interest and similar charges

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

During the year ended 30 September 2022 the impairment allowance remained relatively stable, due to the opposing effects of the easing of Covid-related pressures on the UK economy and mounting concerns about the nation's economic health more generally, with inflation and interest rates increasing and the potential for impacts from the conflict in Ukraine.

The principal movements in the impairment provision in the year ended 30 September 2021 were downwards, with a more benign economic outlook reducing both the estimated likelihood of losses and the expected loss on defaulted cases as security values improved. However coverage levels still remained in excess of those pre-Covid, with PMAs in place to compensate for the potential impact of credit issues not apparent in the data.

While fewer accounts had been granted payment holiday extensions in that year than in the year ended 30 September 2020, this had driven further transfers from Stage 1 to Stage 2. Transfers to Stage 3 reflected principally a small number of realisation cases and other cases identified through credit review. Write offs largely related to the realisation of already provided losses on cases being worked out on a long-term basis.

Impairments charged to income

The amounts charged to the profit and loss account in the period are analysed as follows.

	2022	2021
	£000	£000
Provided in period	28	40
Written off amounts	-	-
	28	40

Economic impacts

Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. While the provision calculation is intended to address all possible future economic outcomes, the Group, in common with most other lenders, uses a small number of differing scenarios as representatives of this universe of potential outturns.

The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all of the variables, the set, as a whole, is defined for the Group and must be consistent.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include data and forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies. The Group also takes account of public statements from bodies such as the Bank of England and the UK Government to inform its final position.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The central scenario used for IFRS 9 impairment purposes is consistent with the scenario which forms the basis of the Group's business planning and forecasting and will therefore generally carry the highest probability weighting. In its September 2022 forecasting cycle (the 'October forecast'), the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2021, with the starting point of the scenario updated to reflect the actual movements of economic variables and expectations in the year. The general trend of the Group's central forecast is broadly negative in the short term, with interest rates and inflation increasing sharply by historical terms in the early part of the five year forecast period before normalising. Short term falls in house prices are also anticipated.

Compared to the central scenario adopted at 30 September 2021, the new central forecast is based on a significantly higher interest rate environment throughout the period, reflecting increases already seen in the second half of the year and clear market expectations of higher rates to come. Inflation is much higher in the early years of the forecast than anticipated twelve months ago, with credit growth more constricted. GDP growth is slowed and house prices less positive in the short term, but recover later. These all reflect a worsening outlook for the UK than anticipated 12 months ago especially in the first two years of the period.

The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. The shapes of these three scenarios are broadly similar across the period, but the degree of divergence of the upside and downside scenarios from the central scenario has been reviewed to ensure that the asymmetrical nature of credit risk is properly accounted for and the full universe of possible outcomes adequately represented.

The severe scenario has been derived from stress testing scenarios published by the Bank of England, as in previous periods, with the 2022 Annual Cyclical Scenario being used at 30 September 2022. This scenario is based on a deep recession, higher interest rates and falling asset prices. To ensure that the scenario is appropriately severe in the Groups circumstances a slightly higher unemployment level and a slightly worse outcome on house prices were assumed, otherwise the appreciation of security values in the later part of the forecast period would negate other impacts.

Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to amend the scenario weightings used at 30 September 2021 for the current year.

The weightings attached to each scenario are set out below

	2022	**2021**
Central scenario	40%	40%
Upside scenario	10%	10%
Downside scenario	30%	35%
Severe scenario	20%	15%
	100%	100%

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

9. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

The economic variables comprising each scenario, and their projected average rates of increase (or decrease) for the first five years of the forecast period are set out below.

30 September 2022

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	2.2	(0.3)	3.5	1.2	2.2	(2.7)	1.2	(5.0)
HPI	4.8	(4.5)	7.5	3.3	4.9	(13.1)	5.7	(17.8)
BBR	5.0	3.0	4.5	3.0	5.5	3.0	6.0	3.3
CPI	10.8	1.4	10.3	1.7	14.0	1.8	17.0	1.8
Unemployment	5.0	3.9	4.5	3.4	6.3	4.1	9.2	4.5
Secured lending	4.0	2.3	4.8	3.1	3.3	1.6	3.7	(1.2)
Consumer credit	5.0	2.5	5.8	3.3	4.3	1.8	4.8	(5.2)

30 September 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	11.5	1.1	13.3	1.6	7.3	0.9	14.3	(5.9)
HPI	6.1	(4.0)	7.7	0.6	2.9	(9.8)	2.4	(16.9)
BBR	0.8	0.1	1.0	0.1	0.5	0.1	0.2	(0.1)
CPI	4.0	1.8	3.8	1.8	4.5	1.8	2.0	0.2
Unemployment	5.5	4.1	4.7	3.8	5.9	4.5	11.9	4.8
Secured lending	4.8	3.0	5.5	3.5	4.0	2.5	3.1	(2.5)
Consumer credit	6.4	0.4	8.5	1.9	4.6	(0.1)	9.2	(8.9)

10. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Hedge accounting is applied where appropriate, though some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under the IAS 39 rules, particularly where the hedged risk relates to an off balance sheet item. In other cases, hedge accounting has not been adopted either because natural accounting offsets are expected or because complying with the IAS 39 hedge accounting rules would be particularly onerous.

The Company's hedging arrangements can be analysed between fair value hedges of portfolio interest rate risk, which are used to manage the interest rate basis risk inherent in fixed rate lending and deposit taking.

In addition, the Company utilises currency derivatives to hedge its exposure on the small amount of its lending denominated in foreign currencies.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

10. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

The analysis below splits derivatives between those accounted for as part of the portfolio fair value and those which, despite representing an economic hedge, do not qualify for this treatment. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2022 or the preceding year.

	2022 Assets £000	2022 Liabilities £000	2021 Assets £000	2021 Liabilities £000
Other derivatives				
Interest rate swaps	15,916	-	1,531	-
Total recognised derivative assets / (liabilities)	15,916	-	1,531	-

The credit risk inherent in the derivative financial assets shown above is discussed in note 16.

Background and hedging objectives

The Company's fair value hedges of portfolios of interest rate risk ('macro hedges') arise from its management of the interest basis risk inherent in its fixed rate lending and deposit taking activities. These activities would expose the Company to movement in market interest rates if not hedged.

This position arises naturally where fixed rate loans are funded with floating rate borrowings, as in the Company's securitisation transactions, but may also arise where retail deposit funding is used. Where possible the Company takes advantage of natural hedging between fixed rate assets and deposit, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. These net exposures are addressed through portfolio hedging arrangements.

This position arises naturally where fixed rate loans are funded with floating or variable rate borrowings but may also arise where retail deposit funding is used. Where possible the Company takes advantage of natural hedging between fixed rate assets and deposits, but it is unlikely that a precise match for value and tenor of the instruments could be achieved leaving unmatched items on both sides. This is referred to as repricing risk and controlled within limits under the Company's interest rate risk management process, described in note 16. In order to manage these exposures, they are hedged with financial derivatives and form part of the Company's portfolio hedging arrangements. Repricing risk is monitored regularly to ensure mismatches or gaps remain within limits set by policy.

Responsibility to direct and oversee structural risk management has been delegated by the Board to ALCO. A hedging strategy is developed for each fixed product considering behavioral characteristics, such as whether a customer is likely to prepay before contractual maturity. This is reviewed from time to time with any changes agreed with ALCO.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

10. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

In order to manage potential exposure to increases in interest rates it may be necessary to undertake pre-hedging of fixed rate assets in the pipeline. Interest rate swaps used to hedge pipeline loan exposures, which are not yet recognised on the balance sheet, can cause unmatched fair value cost or credit to arise until both sides of the hedge can be recognised within the interest rate portfolio hedging arrangement, generally a few months after the inception of the derivative contract.

In managing interest rate exposure, the Treasury function may use interest rate swaps, forward rate agreements, swaptions or interest rate caps and floors. However, interest rate swaps are the most generally used instruments.

The policy creates 'loan hedge' matching fixed rate buy-to-let mortgage assets with interest rate swaps to convert the interest receivable to a floating rate; and

The principal sterling reference rate used by the Company in its interest rate risk management is SONIA (sterling overnight index average). SONIA is an important interest rate benchmark which is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

Where fixed rate assets or liabilities have been hedged with interest rate swaps, these currently reference SONIA.

The designation of the two macro hedges is updated, on a month by month basis, using software which compares the overall tenor, value and rate positions to match the expected fair value movement of the swaps with the expected interest rate risk related movement in the fair value of the relevant assets or liabilities over the designation period as closely as possible. The software applies regression analysis techniques to the potential impact of changes in expected interest rates over the designation period to maximise expected hedge effectiveness on a prospective basis. The value of the portfolio of loans or deposits selected is then designated, as a monetary amount of interest rate risk, as the hedged item, while the portfolio of swaps selected are designated as the hedging instruments.

Any swaps not selected in this process are disclosed as derivatives not in hedging relationships.

At the end of each designation period the Company will assess the effectiveness of each hedge retrospectively, based on fair value movements (relating to interest rate risk components only) which have actually occurred in the period. Movements are compared to pre-determined test thresholds to determine whether the hedge was effective in the period.

Hedging Instruments

The hedging portfolios consist of a large number of sterling denominated swaps. Settlement on all swaps is due quarterly where:

One payment is calculated based on a fixed rate of interest and the nominal value of the swap.

An opposite payment is calculated based on the same nominal value but using a floating interest rate set at a fixed margin over the SONIA reference rate.

Basis exposure on loan assets is hedged by swaps where the Company pays fixed rate and receives floating, that on deposits by swaps where the Company pays floating rate and receives fixed.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

10. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

The Company's other derivatives comprise:

- Interest rate swaps which are economically part of the Company's portfolio hedging arrangements but failed to find a match in the hedge designation, including swaps hedging interest rate risk on the new lending pipeline

The principal terms of this derivatives are set out below.

Interest rate swaps

	2022 Pay Fixed	2021 Pay Fixed
Average fixed notional interest rate		
Average notional margin over SONIA	0.27%	0.24%
	£000	**£000**
Notional principal value		
SONIA swaps	185,000	223,000
	185,000	223,000
Maturing		
Within one year	73,500	10,000
Between one and two years	9,000	101,500
Between two and five years	102,500	111,500
	185,000	223,000
Fair value	15,916	1,531

11. DEBTORS

	2022 £000	2021 £000
Amounts falling due within one year:		
Other debtors	253	154
Prepayments and accrued income	10	15
	263	169

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

12. CALLED UP SHARE CAPITAL

	2022 £	2021 £
Allotted:		
1 ordinary share of £1 (fully paid)	1	1

13. PROVISIONS FOR LIABILITIES

Deferred tax

The movements on the net liability for deferred tax are as follows:

	2022 £000	2021 £000
Balance at 1 October 2021	-	-
Profit and loss credit (note 7)	2,958	-
Rate change (note 7)	934	-
Balance at 30 September 2022	3,892	-

The net deferred tax liability for which provision has been made is analysed as follows:		
Other timing differences	3,892	-

14. CREDITORS

	2022 £000	2021 £000
Amounts falling due within year:		
CSA liabilities	19,526	8,556
Other creditors	8,543	724
Accruals and deferred income	294	223
	28,363	9,503

	2022 £000	2021 £000
Amounts falling due after more than one year:		
Bank loan	170,000	201,000
Subordinated loan	26,572	34,913
	196,572	235,913

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

14. CREDITORS (CONTINUED)

Credit Support Annex ('CSA') liabilities are deposits placed with the Company to act as security for the Company's derivative financial liabilities.

As at 30 September 2020, the Company held a sterling credit facility of £400,000,000. This facility was available for drawing and redrawing until 24 March 2022 for the purpose of funding new first charge mortgage loans. After that the loan has a further one-year workout period for the assets funded to be sold or refinanced. Repayment of the principal drawn is not required unless amounts are realised from the sale or repayment of assets, even after the one-year workout period. The balance outstanding under this credit facility agreement was £170m (2021: £201m).

Interest is payable at a fixed margin, 0.60% above the London Interbank Offered Rate ('LIBOR') on the loan denominated in sterling.

On 8 November 2021, after the year end, revisions to the facility were agreed extending the commitment period for an initial 13-month period with the ability to extend monthly until a potential final maturity date of 24 November 2024. The maximum drawing was increased to £450.0m and the interest rate payable was transitioned to 0.5% above SONIA.

There is a subordinated loan facility repayable to Paragon Mortgages (2010) Limited, a related company. Interest is charged at a rate of 4% above SONIA.

15. RELATED PARTY TRANSACTIONS

The Company has identified the following transactions which are required to be disclosed under the terms of International Accounting Standard 24, 'Related Party Disclosures' ('IAS 24').

Transactions with Paragon Mortgages (2010) Limited ('PM2010')

The subordinated loan made to the Company by PM2010, a company under common control as defined by IAS24, is described in note 14 and interest charged on it is shown in note 3. At the balance sheet date the Company owed £210,000 (2021: £89,000) in relation to subordinated loan interest, which is included in accruals and deferred income.

The Company owed £4,177,000 to PM2010 in relation to deferred purchase consideration, which is included in other creditors (2021: The Company was owed £666,000 from PM2010 at the balance sheet date, relating to monies paid to PM2010, which is included in other debtors).

Transactions with Paragon Bank PLC ('PB')

At the balance sheet date, the Company was owed £253,000 (2021: £154,000) from PB, a company under common control as defined by IAS24, in relation to payments made on behalf of the Company, which is included in other debtors.

The Company owed £3,560,000 (2021: £1,000) to PB relating to monies received by the Company, that are yet to be passed onto PB, which is included in other creditors.

Transactions with Paragon Finance PLC ('PF')

At the balance sheet date PF, a company under common control as defined by IAS 24, acted as servicer of the mortgages for the Company and earned £1,061,000 (2021: £348,000) during the year in servicing fees. At the balance sheet date the Company owed £97,000 (2021: £56,000) to PF in relation to these fees and £29,000 (2021: £9,000) in relation to payments made on behalf of the Company, which is included in other creditors.

NOTES TO THE ACCOUNTS - ANALYSIS

YEAR ENDED 30 SEPTEMBER 2022

15. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with Paragon Mortgages Limited ('PML')

At the balance sheet date, the Company owed £2,000 (2021: £nil) to PML, a company under common control as defined by IAS24, for mortgage fees and insurance which is included in other creditors.

The Company owed £205,000 (2021: £nil) to PML relating to monies received by the Company, that are yet to be passed onto PML, which is included in other creditors.

Transactions with Mortgage Trust Services PLC ('MTS')

At the balance sheet date, the Company owed £7,000 (2021: £nil) to MTS, a company under common control as defined by IAS24, for mortgage fees and insurance which is included in other creditors.

The Company owed £464,000 (2021: £nil) to MTS relating to monies received by the Company, that are yet to be passed onto MTS, which is included in other creditors.

NOTES TO THE ACCOUNTS – FINANCIAL RISK

YEAR ENDED 30 SEPTEMBER 2022

The note below describes the processes and measurements which the Company use to manage their exposure to financial risks including credit, liquidity, interest rate and foreign exchange risk.

16. FINANCIAL RISK MANAGEMENT

The Company's operations are financed principally by a sterling credit facility and, to a lesser extent, by a mixture of share capital and loans from other related entities. The Company drew down the facility to acquire loans. In addition, various financial instruments, for example debtors and accruals, arise directly from the Company's operations.

The principal risks arising from the Company's financial instruments are credit risk, liquidity risk and interest rate risk. The board of the Company's controlling company reviews and agrees policies for all companies in the Group managing each of these risks and they are summarised below.

Credit risk

The Company's credit risk is primarily attributable to its loans to customers. The maximum credit risk at 30 September 2022 approximates to the carrying value of loans to customers. There were no significant concentrations of credit risk due to the large number of customers included in the portfolios.

Mortgages acquired by the Company are secured by first charges over residential properties in the United Kingdom. Despite this security, in assessing credit risk an applicant's ability to repay the loan remains the overriding factor in the decision to lend by the originator. Additionally, each mortgage had the benefit of one or more life assurance policies and certain mortgages have the benefit of a mortgage guarantee indemnity insurance policy.

At 30 September 2022 98.2% (2021: 90.9%) of the Company's mortgage loans by value had a loan-to-value ('LTV') ratio of 70% or less. The weighted average LTV was 57.3% (2021: 62.8%). LTV for each account is calculated by comparing the current balance to the most recent valuation of the mortgaged property, indexed as appropriate.

Paragon Mortgages (2010) Limited, a fellow related entity, continues to administer any loans owned by Paragon Seventh Funding Limited on its behalf and the collections process is the same as that utilised for all companies in the Group.

In order to control credit risk relating to counterparties to the Company's financial instruments, the board of the Company's controlling company determines on a group basis, which counterparties the group of companies will deal with, establishes limits for each counterparty and monitors compliance with those limits.

Liquidity risk

The Company's assets are principally financed by drawing down on the credit facility. Details of the Company's borrowings are given in note 15.

The securitisation process and the terms of the credit facility effectively limit liquidity risk from the funding of the Group's loan assets. It remains to ensure that sufficient funding was available to fund the Group's participation in the SPVs, provide capital support for new loans and working capital for the Group. This responsibility rests with the Asset and Liability Committee which sets the Group's liquidity policy and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

NOTES TO THE ACCOUNTS – FINANCIAL RISK

YEAR ENDED 30 SEPTEMBER 2022

16. FINANCIAL RISK MANAGEMENT (CONTINUED)

Interest rate risk

The Company's policy is to maintain floating rate liabilities and match these with floating rate assets by the use of interest rate swaps.

The rates payable on the sterling credit facility are reset on the basis of LIBOR. The Company's assets predominantly bear LIBOR linked interest rates or are hedged fixed rate assets. The interest rates charged on the Company's variable rate loan assets were determined by reference to, inter alia, the Company's funding costs and the rates being charged on similar products in the market. Generally this ensures the matching of changes in interest rates on the Company's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term.

Currency risk

The Company has no material exposure to foreign currency risk.

Use of derivative financial instruments

The Company uses derivative financial instruments for risk management purposes. Such instruments were used only to limit the exposure of the Company to movements in market interest or exchange rates, as described above.

It is, and has been throughout the period under review, the Company's policy that no trading in financial instruments shall be undertaken, and hence all of the Company's derivative financial instruments are for commercial hedging purposes. These are used to protect the Company from exposures principally arising from fixed rate lending or borrowing. Hedge accounting is applied where appropriate, though it should be noted that some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under IAS 39 either because natural accounting offsets are expected, or obtaining hedge accounting would be especially onerous.

The Company had designated a number of derivatives as fair value hedges. In particular this treatment is used for hedging the interest rate risk of groups of fixed rate prepayable loan assets with interest rate derivatives on a portfolio basis. The Company believes this solution is the most appropriate as it is consistent with the economic hedging approach taken by the Company to these assets.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

The notes set out below describe the accounting basis on which the Company prepare their accounts, the particular accounting policies adopted by the Company and the principal judgements and estimates which were required in the preparation of the financial statements.

They also include other information describing how the accounts have been prepared required by legislation and accounting standards.

17. BASIS OF PREPARATION

The Financial Statements have been prepared in accordance with applicable United Kingdom ('UK') accounting standards. Disclosures have been made in accordance with Financial Reporting Standard 101 – 'Reduced Disclosure Framework' ('FRS 101').

As permitted by FRS 100 – 'Application of Financial Reporting Requirements' ('FRS 100') the Company has applied the measurement and recognition requirements of International Financial Reporting Standards as adopted by the UK (UK-adopted international accounting standards) ('UK-IAS') but makes amendments where necessary in order to comply with the Companies Act 2006 and has set out below where advantage of disclosure exemptions provided by FRS 101 has been taken.

On 31 December 2020, EU-adopted International Financial Reporting Standards ('IFRS') was brought into UK law and become UK-IAS, with future changes to IFRS being subject to endorsement by the UK Endorsement Board. In preparing these financial statements in accordance with FRS 101, the Company Financial Statements transitioned to UK-adopted international accounting standards (as described above) in its first financial year commencing after 1 January 2021. There is no impact on recognition, measurement or disclosure in the period reported as a result of this change.

The particular accounting policies adopted have been set out in note 18 and the critical accounting judgements and estimates which have been regarded in preparing these financial statements are described in notes 19 and 20 respectively.

Adoption of new and revised reporting standards

In the preparation of these financial statements, no new accounting standards are being applied for the first time.

Standards not yet adopted

There are no standards and interpretations in issue but not effective which address matters relevant to the Company's accounting and reporting.

18. ACCOUNTING POLICIES

Accounting convention

The Financial Statements are prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

Going concern

The financial statements of the Company for the year ended 30 September 2022 have been prepared on the going concern basis, as defined in IAS 1 – 'Presentation of Financial Statements'. In order to prepare financial statements on this basis the directors must conclude that the management does not intend to liquidate the Company or cease trading, and that the Company has the ability to continue to trade and will be able to satisfy its liabilities as they fall due.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

18. ACCOUNTING POLICIES (CONTINUED)

Going concern (continued)

As a result of the transaction documents governing the Company's bank loan borrowings the Company will continue to trade in the same way as it did in the year ended 30 September 2022 until either:

- All of the bank loan is repaid from principal cash flows arising from the Company's mortgage portfolio; or
- Was available for drawing and redrawing until 24 November 2024 for the purpose of funding new first charge mortgage loans. After that the loan has a further one-year workout period for the assets funded to be sold or refinanced.

The directors have reviewed the balance sheet performance of the company and consider that it is unlikely that any of these events will occur within twelve months of the date of approval of these financial statements.

Before this point, repayments of the principal liabilities of the Company, the bank loan, are limited to available principal cash received on the Company's loan portfolio until the final repayment date. Therefore, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence until this point, satisfying all liabilities as they fall due.

On the basis of this analysis, the directors have concluded that the Company is able to continue as a going concern for at least twelve months from the date of approval of these financial statements and that therefore it is appropriate to continue to adopt the going concern basis in the preparation of these financial statements.

Loans to customers

Loans to customers includes assets accounted for as financial assets. The Company assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and its business model for managing the asset. The Company has concluded that its business model for its customer loan assets is of the type defined as 'Hold to collect' by IFRS 9 and the contractual terms of the asset should give rise to cash flows that are solely payments of principal and interest ('SPPI'). Such loans are therefore accounted for on the amortised cost basis.

Loans advanced are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procuration fees paid to brokers or other business providers and less initial fees paid by the customer. Loans acquired from third parties are initially valued at the purchase consideration paid or payable. Thereafter, all loans to customers are valued at this initial amount less the cumulative amortisation calculated using the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by a provision impairment.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payments and receipts arising from the loan to the initial carrying amount.

Impairment of loans and receivables

The carrying values of all loans to customers, whether accounted for under IFRS 9 or IAS 17, are reduced by an impairment provision based on their expected credit loss ('ECL'), determined in accordance with IFRS 9. These estimates are reviewed throughout the year and at each balance sheet date.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

18. ACCOUNTING POLICIES (CONTINUED)

Impairment of loans and receivables (continued)

All assets are assessed to determine whether there has been a significant increase in credit risk (‘SICR’) since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are ‘Credit Impaired’. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

Assets which have not experienced an SICR are referred to as ‘Stage 1’ accounts, assets which have experienced an SICR but are not credit impaired are referred to as ‘Stage 2’ accounts, while credit impaired assets are referred to as ‘Stage 3’ accounts.

An impairment allowance is provided on an account by account basis:

- For Stage 1, at an amount equal to 12-month ECL, i.e. the total expected ECL that results from those default events that are possible within 12 months of the reporting date, weighted by the probability of those events occurring
- For Stage 2 and 3 accounts, at an amount equal to lifetime ECL, i.e. the total expected ECL that results from any future default events, weighted by the probability of those events occurring.

In establishing an ECL allowance, the Company assesses its probability of default, loss given default and exposure at default for each reporting period, discounted to give a net present value. The estimates used in these assessments must be unbiased and take into account reasonable and supportable information including forward-looking economic inputs.

While the Company uses statistical models as the basis for its calculation of ECLs where appropriate, expert judgement will always be used to assess the adequacy of any calculated amount and additional provision made if required.

Within its buy-to-let portfolio the Company utilises a receiver of rent process, whereby the receiver stands between the landlord and tenant and will determine an appropriate strategy for dealing with any delinquency. This strategy may involve the immediate sale of any underlying security or the short or long term letting of the property to cover arrears and principal shortfalls. Such cases are automatically considered to have an SICR, but where a letting strategy is adopted by the receiver, a tenant is in place and arrears are reduced or cleared, the account will not necessarily be considered to be credit impaired. Properties in receivership are eventually either returned to their landlord owners or sold.

For financial accounting purposes, provisions for impairments of loans to customers are held in an impairment allowance account from the point at which they are first recognised. These balances are released to offset against the gross value of the loan when it is written off for accounting purposes. This occurs when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. Any further gains from post-write off salvage activity are reported as impairment gains.

Cash at bank

Balances shown as cash at bank in the balance sheet comprise demand deposits and short-term deposits with banks with initial maturities of not more than 90 days.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

18. ACCOUNTING POLICIES (CONTINUED)

Current tax

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the profit and loss account as interest payable over the term of the borrowing on an Effective Interest Rate basis.

Derivative financial instruments

Derivative instruments utilised by the Company comprise interest rate swaps. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Company in line with the Company's risk management policies (note 16).

The Company does not enter into speculative derivative contracts.

All derivatives are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the profit and loss account, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

Hedging

IFRS 9 paragraph 7.2.21 permits an entity to elect, as a matter of accounting policy, to continue to apply the hedge accounting requirements of IAS 39 in place of those set out in Chapter 6 of IFRS 9. The Company has made this election and the accounting policy below has been determined in accordance with IAS 39.

For all hedges, the Company documents, at inception, the relationship between the hedging instruments and the hedged items, as well as its risk management strategy and objectives for undertaking the transaction. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by IAS 39.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of IAS 39, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk.

For macro hedges (hedges of interest rate risk for a portfolio of loan assets) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

18. ACCOUNTING POLICIES (CONTINUED)

Hedging (continued)

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the profit and loss account at the same time as the hedged item affects the profit and loss account. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction is recognised, or is no longer highly probable.

For macro hedges (hedges of interest rate risk for a portfolio of loan assets) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of IAS 39. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the profit and loss account at the same time as the hedged item affects the profit and loss account. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged occurs, or is no longer expected to take place.

Fee and commission income

Other income includes administration fees charged to borrowers, which are credited to the profit and loss account when the related service is performed.

Revenue

The revenue of the Company comprises interest receivable and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

Disclosures

In preparing these financial statements the Company has taken advantage of the exemptions from disclosure provided by FRS 101 in respect of:

- The requirement to produce a cash flow statement and related notes
- Disclosures in respect of transactions with wholly owned subsidiaries
- Disclosures in respect of capital management
- The effects of new, but not yet effective IFRSs
- Disclosures in respect of key management personnel
- Disclosures of transactions with a management entity which provides key management personnel services to the Company

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

18. ACCOUNTING POLICIES (CONTINUED)

Disclosures (continued)

As the consolidated financial statements of Paragon Banking Group PLC, the ultimate parent undertaking of the Company, include equivalent disclosures the Company has also taken advantage of these further exemptions provided by FRS 101:

- Certain disclosures required by IFRS 13 – 'Fair Value Measurement'
- Certain disclosures required by IFRS 7 – 'Financial Instruments Disclosures'

The Company presently intends to continue to apply these exemptions in future periods.

19. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 18 relate to:

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated probability of default, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have a SICR, for account types where days overdue is an appropriate measure.

As part of its consideration of the adequacy of its impairment provisioning, management have considered whether there are any factors not reflected in its normal approach which indicate that a group, or groups of accounts should be considered as having an SICR. No such accounts were identified.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision, as such cases are provided on the basis of lifetime expected loss, rather the 12-month expected loss, and the overall provision charge would be higher. Conversely, if cases are incorrectly identified as SICR, impairment provisions will be overstated. Furthermore, adjustments to current PD estimates in the Group's models may also have the effect of identifying more or less accounts as having an SICR.

More information on the definition of SICR adopted is given in note 9.

Definition of default

In applying the impairment provisions of IFRS 9, the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Group's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default.

If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Group's definition of default adopted is given in note 9.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

19. CRITICAL ACCOUNTING JUDGEMENTS (CONTINUED)

Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business model' – how it intends to generate cash and profit from the assets
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through other comprehensive income, or at fair value through profit or loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Group has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all the Group's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Group's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Group does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Company has classified its customer loan assets as carried at amortised cost. There were no significant changes in the nature of the Group's products, nor in the business models in which they are held, during the year.

20. CRITICAL ACCOUNTING ESTIMATES

Certain balances reported in the Financial Statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most important of these, those which could, if revised significantly in the next financial year, have a material impact on the carrying amounts of assets or liabilities are::

Impairment losses on loans to customers

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (e.g. keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

20. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

Impairment losses on loans to customers (continued)

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

In evaluating the potential impact of the economic situation at 30 September 2022 this process is made more complex by both the elevated level of uncertainties and the lack of recent experience of similar situations against which to benchmark. At the same time, the level to which Covid-related 'scarring' has yet to manifest itself in credit metrics is still unclear.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Company must derive a set of scenarios which are internally coherent. The Company addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 30 September 2022 have been derived in light of the current economic situation, at that date, modelling a variety of possible outcomes as described in note 9. It should be noted, however, that there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK, which have diverged again over the period since September 2021, with both UK economic and geopolitical uncertainties building.

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the house price index

The economic variables will also inform assumptions about the Company's approach to account management given a particular scenario.

NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

YEAR ENDED 30 SEPTEMBER 2022

20. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

Impairment losses on loans to customers (continued)

In addition to uncertainty created by the economic scenarios, the Group recognises that the present situation lies outside the range of situations considered when it originally derived its IFRS 9 approach to impairment. It is considered that the current forecast scenarios, which include higher rates of interest and inflation than in the historically observed data, represent situations where its models may not be able to fully allow for potential economic impacts on its loan portfolios. It therefore assessed, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

As a result of this exercise additional requirements for provision were identified for the year ended 30 September 2021, to compensate for potential model weakness and to allow for economic pressures in the wider economy which cannot be identified by a modelled approach. By their nature such adjustments are less systematic and therefore subject to a wider range of outturns. No adjustments were required for the year ended 30 September 2022.

The position after considering all these matters is set out in note 9.

Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each loan and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased accounts this will involve estimating the likely future performance of the accounts at the time of acquisition. For each portfolio a model is in place to ensure that income is appropriately spread.

The underlying estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and those predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

21. ULTIMATE PARENT COMPANY

The ultimate parent undertaking is Intertrust Corporate Services Limited who holds the entire share capital of the Company on a discretionary trust basis for the benefit of certain charities. The directors regard Paragon Banking Group PLC as the ultimate controlling party.

The smallest and largest group in which the Company is consolidated is that of the Paragon Banking Group PLC.

Copies of the Group's financial statements are available from that company's registered office at 51 Homer Road, Solihull, West Midlands, B91 3QJ.