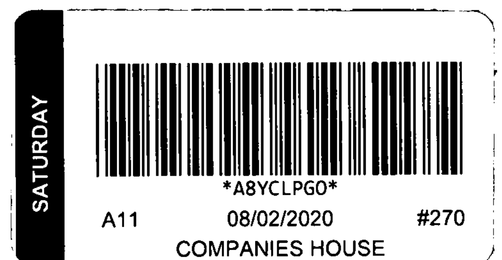
Company Registration No: 05393650

PARAGON MORTGAGES (NO. 13) PLC

Report and Financial Statements

Year ended 30 September 2019



STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

Paragon Mortgages (No.13) PLC ('the Company') is a wholly owned subsidiary of Paragon Banking Group PLC ('the Group') and was set up to provide finance for its mortgage loan assets, by issuing mortgage backed floating rate loan notes and using the proceeds to purchase mortgage loans from other group companies.

During the year the Company operated in the United Kingdom, its principal activities are the provision of first mortgage loans. There have been no significant changes in the Company's principal activities in the year under review. The directors are not aware, at the date of this report, of any likely major changes in the Company's activities in the next year.

The Company has applied International Financial Reporting Standard ('IFRS') 9 – 'Financial Instruments' in calculating its provisions for impairment for the first time in the year. As prior year charges are not required to be restated, the 2019 charge is not strictly comparable to that for 2018.

As shown in the Company's profit and loss account on page 11, the Company's net interest income decreased by 9% compared to the prior year (2018: 16% decrease). This was principally reflecting the reduction in the Company's loan book during the year. The loss after tax has increased from £1,194,000 to £1,250,000. This was mainly due to a decrease in net interest income during the year.

The balance sheet on page 12 of the Financial Statements shows the Company's financial position at the year end. Loans to customers have decreased by 7% due to customers redeeming and repaying their accounts. As a result, the asset backed loan notes have reduced by 7% during the year, excluding the fair value adjustment in respect of the cross currency swaps. Details of amounts owed from and to other group companies are shown in notes 15 and 19.

No interim dividend was paid during the year (2018: £nil). No final dividend is proposed (2018: £nil).

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 Group's Annual Report, which does not form part of this Report.

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 likelihood of this occurring has become more difficult to forecast given the continuing material uncertainties regarding the UK's withdrawal from the European Union.

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 7, a discussion of critical accounting judgements is set out in note 5 and a discussion of critical accounting estimates is set out in note 6.

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 4.

ENVIRONMENT

The Group recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by the Group's activities. The Company operates in accordance with group policies, which are described in the Group's Annual Report, which does not form part of this Report.

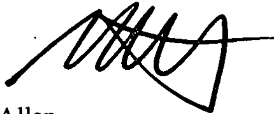
STRATEGIC REPORT (CONTINUED)

EMPLOYEES

The Company has no employees. All operational services are provided by employees of the Group. The Group's employment policies are described in its Annual Report, which does not form part of this Report.

Approved by the Board of Directors

and signed on behalf of the Board



K G Allen

Director

24 January 2020

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 Mortgages (No.13) PLC, a company registered in England and Wales with registration no: 05393650, for the year ended 30 September 2019.

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 throughout the year and subsequently were:

R D Shelton

R J Woodman

J Fairrie (resigned 19 November 2018)

K G Allen

J P Giles

P H Whitaker

AUDITOR

The directors have taken all reasonable steps to make themselves and the Company's auditor, KPMG LLP, 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.

A resolution for the re-appointment of KPMG LLP as the auditor of the Company is to be proposed at the forthcoming Annual General Meeting.

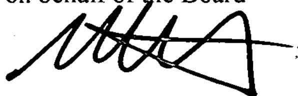
INFORMATION PRESENTED IN OTHER SECTIONS

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 7 to the accounts.
- Disclosure on any dividends paid during the year is included in the Strategic Report.

Approved by the Board of Directors

and signed on behalf of the Board



K G Allen

Director

24 January 2020

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

STATEMENT OF DIRECTORS' RESPONSIBILITIES
in relation to Financial Statements

The directors are responsible for preparing the Annual Report and the 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 the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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 and of their profit or loss for that period.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets, for the Company's systems of internal control and for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a strategic report and directors' report which comply with the applicable requirements of the Companies Act 2006.

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

Pandora Sharp

Company Secretary

24 January 2020

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF PARAGON MORTGAGES (NO. 13) PLC

1 Our opinion is unmodified

We have audited the Financial Statements of Paragon Mortgages (No. 13) PLC ('the Company') for the year ended 30 September 2019 which comprise the:

- Profit and Loss Account
- Statement of Comprehensive Income
- Balance Sheet
- Statement of Movements in Equity
- Related notes, including the accounting policies in note 4.

In our opinion, the Financial Statements:

- the financial statements give a true and fair view of the state of the Company's affairs as at 30 September 2019 and of its loss for the year then ended;
- the financial statements have been properly prepared in accordance with UK accounting standards, including Financial Reporting Standard 101 – 'Reduced Disclosure Framework'; and
- the financial statements 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 believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to those charged with governance.

We were appointed as auditor by the shareholders on 9 February 2016. The period of total uninterrupted engagement is for the four financial years ended 30 September 2019. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

2 Material uncertainty related to going concern

	The Risk	Our Response
Going concern We draw attention to note 20 of the financial statements which indicates that since October 2010 the Company has the option, at any interest payment date, to repay all of its outstanding external borrowings at their carrying value at the time. At the date of signing the audit report the directors are uncertain whether, and if so, when the outstanding external borrowings will be repaid. These events and conditions, along with the other matters explained in note 4 to the financial statements, constitute a material uncertainty that may cast significant doubt on the company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.	**Disclosure quality** The directors' described in note 4 of the financial statements, the risks and circumstances that resulted in a material uncertainty over the ability of the company to continue as a going concern for a period of at least a year from the date of approval of the financial statements. Clear and full disclosure of the facts and the directors' rationale for the use of the going concern basis of preparation, including that there is a related material uncertainty, is a key financial statement disclosure and so was the focus of our audit in this area. Auditing standards require that to be reported as a key audit matter.	**Our procedures included:** • **Assessing transparency** – Assessing the completeness and accuracy of the matters covered in the going concern disclosure by considering the structure of the entity by reference to the prospectus and enquiry of the directors as to the likelihood of exercise of the option. - Assessing the going concern disclosure for adequacy, including that there is a disclosure of a material uncertainty. **Our results** We found the disclosure of the material uncertainty to be acceptable.

3 Other key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Key audit matter	Our response
The impact of uncertainties due to the UK exiting the European Union on our audit Risk vs 2018: ▲ *Refer to the Strategic Report* ***Unprecedented levels of uncertainty*** All audits assess and challenge the reasonableness of estimates, in particular as described in impairment allowances on loans to customers, interest receivable on loan accounts, below, and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (see below). All of these depend on assessments of the future economic environment and the Company's future prospects and performance. Brexit is one of the most significant economic events for the UK and the effects are subject to unprecedented levels of uncertainty of consequences, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: • **Our Brexit knowledge** – We considered the directors' assessment of Brexit-related sources of risk for the Company's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. • **Sensitivity analysis** – When addressing impairment allowances on loans to customers, interest receivable on loan accounts, and other areas that depend on forecasts, we compared the directors' analysis to our assessment of the full range of reasonably possible scenarios resulting from Brexit uncertainty and, where forecasts cash flows are required to be discounted, considered adjustments to discount rates for the level of remaining uncertainty. • **Assessing transparency** – As well as assessing individual disclosures as part of our procedures on impairment allowances on loans to customers, interest receivable on loan account on our audit we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. **Our results** As reported under Impairment allowances on loans to customers, interest receivable on loan accounts, we found the resulting estimates and related disclosures of Impairment allowances on loans to customers, interest receivable on loan accounts, and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Impairment allowances on loans to customers	Our audit procedures included:
Risk vs 2018: ▲ (£2,020k; 2018: £4,081k) *Refer to the accounting policy note 4 and note 13 (financial disclosures).* ***Subjective estimate*** IFRS 9 was implemented by the Company on 1 October 2018. This new and complex standard requires the Company to recognise expected credit losses ('ECL') on financial instruments, which involves significant judgement and estimates and resulted in an increase in credit loss provisions. The quantum and timing of cashflows as well as the realisation rate are key assumptions in the provision calculation in that portfolio. The key areas where we identified greater levels of director judgement and therefore increased levels of audit focus in the Company's implementation of IFRS 9 are: **Economic scenarios** – IFRS 9 requires the Company to measure ECLs on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determining the economic scenarios used and the probability weightings applied to its lending portfolios. **Significant Increase in Credit Risk ('SICR')** – For the portfolios the criteria selected to identify a significant increase in credit risk is a key area of judgement within the Company's ECL calculation as these criteria determine whether a 12 month or lifetime provision is recorded. **Model estimations** – Inherently judgemental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD models used in the portfolios are the key drivers of the Company's ECL results and are therefore the most significant judgemental aspect of the Company's ECL modelling approach. The effect of these matters is that, as part of our risk assessment, we determined that the impairment of loans to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. **Disclosure quality** The disclosures regarding the Company's application of IFRS 9 are key to understanding the change from IAS 39 as well as explaining the key judgements and material inputs to the IFRS 9 ECL results.	— Controls testing: We performed end to end process walk-throughs to identify the key systems and controls used in the ECL processes. We tested the relevant general IT and applications controls over key systems used in the ECL process. — Test of details: Key aspects of our testing involved: - Testing the key inputs and assumptions impacting the Company's overall ECL calculation to assess their reasonableness. This included performing sensitivity analysis to understand the significance of certain assumptions; benchmarking procedures to compare the Company's key assumptions to comparable peer group organisations; and assessing the key assumptions against the Company's historical experience; - Performing credit file reviews over individual loans in the Company's loan portfolios on a risk assessed sample basis to assess the reasonableness of the ECL measured on certain loans; and - Performing recalculations of the ECL measured on portfolios on a samples basis. — Our financial risk modelling expertise: We involved our own financial risk modelling specialists in evaluating the IFRS 9 model. We used our knowledge of the Company and our experience of the industry that the Company operates in to independently assess the appropriateness of the Company's IFRS 9 model and key components. — Our economic scenario expertise: We involved our own economic specialists to assist us in assessing the appropriateness of the Company's methodology for determining the economic scenarios used and the probability weightings applied to them. We also assessed key economic variables used which included agreeing samples of economic variables to external sources as well as the overall reasonableness of the economic forecasts by comparing the Company's forecasts to our own modelled forecasts. As part of this work we assessed the reasonableness of the Company's considerations of the ECL impact of economic uncertainty, including Brexit. — Assessing transparency: We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Company's overall ECL. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear. **Our results** The results of our testing were satisfactory and we considered the credit impairment charge, provision recognised and the related disclosures to be acceptable.

Interest receivable on loan accounts	**Our procedures included:**
(£17,671k; 2018: £16,787k) Risk vs 2018: ◄► *Refer to page 11 (profit and loss account) and the accounting policy note 4.* ***Subjective estimate*** The recognition of interest receivable on loan accounts under the effective interest rate ("EIR") method requires the directors to apply judgement, with the most critical estimate being the loans' expected behavioural life for originated assets. The expected life assumptions utilise repayment profiles which represent how customers are expected to pay. These profiles extend significantly into the future which creates a high level of estimation uncertainty and subjects the judgement to future market changes. The Company makes its expected life assumptions based on its forecasting process which incorporates both historical experience and judgemental overlays by management.	Historical comparison: We critically assessed the Company's analysis and key assumptions over the repayment profiles by comparing them to the Company's historical trends and actual portfolio behaviour; this included assessing the appropriateness of the cohort segmentation and the treatment of product switches; and Sensitivity analysis: We performed sensitivity analysis over the repayment profiles by applying alternative profiles based upon the above procedures. Assessing transparency: We critically assessed the adequacy of the Company's disclosures about the sensitivity of the interest receivable on loan accounts to changes in key assumptions reflected in the inherent risk; and Controls: We tested management review controls over the approval of the Company's repayment profiles; Our results We found the resulting estimate of interest receivable on loan accounts and the related disclosures to be acceptable (2018: acceptable).

4 Our application of materiality and an overview of the scope of our audit

Materiality for the Company financial statements as a whole was set at £6.50 million (2018: £5.76 million), determined with reference to a benchmark of Company's total assets (of which it represents 0.76% (2018: 0.63%).

We agreed to report to Those Charged with Governance any corrected or uncorrected identified misstatements exceeding £0.32 million (2018: £0.29 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the Company was undertaken to the materiality level specified above and was all performed at the Company's head office in Solihull.

5 We have nothing to report on the Strategic Report and the Directors' Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information 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 other information.

Strategic report and directors' report

Based solely on our work on the other information:

- 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.

6 We have nothing to report on the other 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 by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company 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.

7 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 4 the directors are responsible for: the preparation of the financial statements including 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 other irregularities (see below), 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, other irregularities 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.

Irregularities – ability to detect

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 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.

Whilst the company is subject to many other laws and regulations, we did not identify any others where the consequences of non-compliance alone could have a material effect on amounts or disclosures in the financial statements.

These limited procedures did not identify actual or suspected non-compliance.

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 (irregularities) 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 irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8 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.

Simon Clark (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

One Snowhill, Snow Hill Queensway, Birmingham, B4 6GH

24 January 2020

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2019

	Note	2019 £000	2018 £000
Interest receivable			
Mortgages		17,671	16,787
Other		302	245
		17,973	17,032
Interest payable and similar charges	8	(10,494)	(8,846)
Net interest income		7,479	8,186
Other operating income		68	69
Total operating income		7,547	8,255
Operating expenses		(9,782)	(9,903)
Provisions for losses	13	461	174
Operating loss, being loss on ordinary activities before taxation	10	(1,774)	(1,474)
Tax on loss on ordinary activities	11	524	280
Loss on ordinary activities after taxation	17	(1,250)	(1,194)

All activities derive from continuing operations.

STATEMENT OF COMPREHENSIVE INCOME

YEAR ENDED 30 SEPTEMBER 2019

	2019 £000	2018 £000
Loss for the year	(1,250)	(1,194)
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss		
Cash flow hedge profit taken to equity	167	17
Tax on items taken directly to equity	(45)	(3)
Other comprehensive income for the year net of tax	122	14
Total comprehensive income for the year	(1,128)	(1,180)

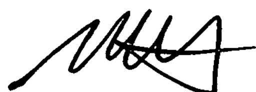
BALANCE SHEET

30 SEPTEMBER 2019

	Note	2019 £000	2019 £000	2018 £000	2018 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Financial assets	12		812,764		867,422
CURRENT ASSETS					
Debtors falling due within one year	15	358		190	
Cash at bank		46,873		45,732	
			47,231		45,922
			859,995		913,344
FINANCED BY					
EQUITY SHAREHOLDERS' FUNDS					
Called up share capital	16	12		12	
Cash flow hedging reserve	17	473		351	
Profit and loss account	17	6,575		9,487	
			7,060		9,850
PROVISIONS FOR LIABILITIES	18		1,374		2,219
CREDITORS					
Amounts falling due within one year	19	9,188		7,962	
Amounts falling due after more than one year	19	842,373		893,313	
			851,561		901,275
			859,995		913,344

These Financial Statements were approved by the Board of Directors on 24 January 2020.

Signed on behalf of the Board of Directors



K G Allen

Director

STATEMENT OF MOVEMENT IN EQUITY

YEAR ENDED 30 SEPTEMBER 2019

	Share capital	Cash flow hedging reserve	Profit and loss account	Total equity
	£000	£000	£000	£000
Total comprehensive income for the year				
Loss for the year	-	-	(1,250)	(1,250)
Other comprehensive income	-	122	-	122
Total comprehensive income for the year	-	122	(1,250)	(1,128)
Opening equity	12	351	9,487	9,850
Change in accounting policy on adoption of IFRS9	-	-	(1,662)	(1,662)
As restated	12	351	7,825	8,188
Closing equity	12	473	6,575	7,060

YEAR ENDED 30 SEPTEMBER 2018

	Share capital	Cash flow hedging reserve	Profit and loss account	Total equity
	£000	£000	£000	£000
Total comprehensive income for the year				
Loss for the year	-	-	(1,194)	(1,194)
Other comprehensive income	-	14	-	14
Total comprehensive income for the year	-	14	(1,194)	(1,180)
Opening equity	12	337	10,681	11,030
Closing equity	12	351	9,487	9,850

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

1. GENERAL INFORMATION

Paragon Mortgages (No. 13) PLC ('the Company') is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 05393650. 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.

2. BASIS OF PREPARATION

The Financial Statements have been prepared in accordance with applicable 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 ('IFRS') as adopted by the EU, 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.

Adoption of new and reviewed reporting standards

In the preparation of these financial statements, the following accounting standards are being applied for the first time.

- IFRS 9 – 'Financial Instruments' (together with consequential changes to IFRS 7 - 'Financial Instruments: Disclosures')

The effect on the Company's accounting of the adoption of these standards is discussed in note 3.

Comparability of information

IFRS9 does not require that the balance sheet information at 30 September 2018 and the profit and loss information for the year ended on 30 September 2018 to be restated on the adoption of the Standard. The information presented for those periods in these financial statements is derived in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39'), and therefore may not be directly comparable with the balance sheet at 30 September 2019 and the profit and loss account for the year then ended which are prepared under IFRS 9.

3. CHANGES IN ACCOUNTING STANDARDS

The Company is required to adopt IFRS 9 (and the consequent changes to IFRS 7) for the first time in preparing its financial statements for the year ended 30 September 2019.

IFRS 9 – Overview

IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') and addresses the recognition, classification and measurement of financial assets and liabilities. The Group published a report on its transition to IFRS 9 on 22 March 2019 which is available from the investor section of the Group's website at www.paragonbankinggroup.co.uk.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

IFRS 9 – Classification

IFRS 9 changes the classification requirements for financial assets and liabilities. In order for financial assets to be carried at amortised cost under the new standard, they must be carried in a business model whose objective is to collect the contractual cash flows from the assets and where those cash flows comprise solely payments of principal and interest ('SPPI'). Further information on this judgement is given in note 5.

In accordance with the new rules:

Cash balances and loans to customers, which were classified as 'loans and receivables' under IAS 39 are classified as 'financial assets measured at amortised cost' under IFRS 9 and continue to be measured on the amortised cost basis

External borrowings, which were classified as 'other financial liabilities' under IAS 39 are classified as 'financial liabilities measured at amortised cost' and continue to be measured on the amortised cost basis

Derivative financial assets and liabilities, which were carried at fair value under IAS 39 are classified as 'financial assets or liabilities at fair value through profit and loss' under IFRS 9 and continue to be measured on the same basis

The amortised cost and fair value measurement methodologies remain broadly the same in IFRS 9 as they were in IAS 39 and no measurement changes in the accounts of the Company have arisen as a result of these classification changes.

The only changes arising from a change in measurement on transition to IFRS 9 relate to impairment provision on the Company's loans to customers. These are discussed further below.

The Company's financial asset and financial liability balances measured in accordance with IFRS 9 and the preceding standard, IAS 39, at the transition date (1 October 2018) are set out below:

	Post-transition £000	Pre-transition £000
Financial Assets		
Cash at bank	45,732	45,732
Loans to customers	761,845	763,846
Derivative financial assets	103,576	103,576
Amounts due from group companies	140	140
	911,293	913,294
Financial Liabilities		
Asset backed loan notes	761,666	761,666
Intercompany Subordinated loan	28,504	28,504
Amounts due to group companies	5,327	5,327
	795,497	795,497

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

IFRS 9 – Impairment

IFRS 9 changes the basis of impairment provision for all financial assets from an incurred loss to an expected credit loss ('ECL') basis. Therefore, the provisioning is dependent on an assessment of the probability of future default and the loss which might be incurred at that time. This introduces significant additional areas of estimation to the accounting.

This introduces a number of new concepts and changes to the approach required by IAS 39. 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. This has the effect of recognising losses on loans earlier than at present, as IAS 39 requires provisions to be made only at the point where a loss has actually occurred and there is objective evidence of credit impairment.

The Standard also requires that companies calculate impairment under a variety of differing economic scenarios and combine these on a weighted average basis to arrive at the final provision, rather than base calculations on a central forecast, as is generally the case under IAS 39.

IFRS 9 requires loan assets to be divided into three 'stages', with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no Significant Increase in Credit Risk ('SICR') since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are credit impaired (Stage 3). It is an important feature of the standard that SICR is not defined solely by the performance of the account, but also by other information available about the customer both internally and externally, such as credit bureau information.

- 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. These accounts would be largely unprovided for under IAS 39, although some cases with adverse qualitative indicators might have been addressed by a collective emergence provision. Such provisions under IAS 39 were designed to cover assets where a loss event had occurred before the reporting date, but this event had not yet affected performance
- 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. This is likely to lead to an increase in provision in general, though the IAS 39 emergence provision would have also addressed some of this risk

Under IAS 39 the Company treated all loan accounts as live where they remained open on its administration system. IFRS 9 requires a firm to consider the prospect of future recovery in its write off approach and the Company has adopted a revised accounting policy for write offs following transition.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

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

All accounts which would have been written off for accounting purposes prior to the transition date under the new policy have been written off at transition. All of these cases were fully provided and therefore this has had no impact on reserves.

The introduction of IFRS 9 resulted in an increase in the Company's impairment provision of £2,001,000 at the transition date, 1 October 2018. The impacts by business segment are set out below:

	IAS 39 £000	IFRS 9 £000	Change £000	Change %
Loans to customers				
Mortgages	763,846	761,845	(2,001)	(0.26) %
Total	763,846	761,845	(2,001)	(0.26) %

The movement in impairment provisions in the Company's accounts between the balance disclosed under IAS 39 and the opening balance under IFRS 9 is set out below.

	£000
Impairment on loans to customers	
At 30 September 2018 under IAS 39	11,100
IFRS 9 transition adjustments	2,001
Change in write-off definition	(9,020)
At 1 October 2018 under IFRS 9	4,081

The reduction due to write off definitions is principally attributable to part redeemed loan balances which remained live on the administration systems of the Company and were therefore treated as live for accounting purposes. Under IFRS 9 these balances may be defined as written off, and the Company's IFRS 9 write off policy considers them to be so, as this provides users with a more useful measure of provision cover.

The increase in impairment on transition will be allowed as a deduction for the purposes of UK Corporation Tax under the Change in Accounting Practices Regulations. This is spread over the ten years following transition for loan assets and is allowable in the 2019 tax computations for finance leases. A deferred tax asset of £340,000 has been recognised on transition.

Cash balances and the amounts due from group companies balance shown in note 15 are classified as financial assets accounted for at amortised cost and are therefore subject to the impairment provisions of IFRS 9. However, these assets are principally exposures to highly rated banks. The ECLs on these counterparties are considered to be minimal. The value, tenor and potential for default of the other exposures is such that any potential IFRS 9 provision is insignificant.

Derivative financial assets are carried at fair value, which includes the consideration of credit risk, as they were under IAS 39.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

IFRS 9 – Hedge accounting

The hedge accounting requirements of IFRS 9 do not specifically address portfolio fair value hedges of interest rate risk ('macro hedges') which IAS 39 deals with directly. A separate financial reporting standard is to be developed in this area. IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented.

As the Company's hedging arrangements are either macro hedges, which are not specifically addressed by the new standard, or bespoke cash flow hedges, which would not be affected by the change of standard, the Company has decided to defer application of these rules until the full new hedge accounting regime is in place.

It thus continues to apply the hedge accounting requirements of IAS 39 and all hedging arrangements in place at 30 September 2018 continue to be recognised on 1 October 2018 after IFRS 9 transition.

However, the consequential changes to IFRS 7 (see below) do apply to these financial statements and the Company's disclosures in respect of hedge accounting and derivatives have been revised and expanded.

IFRS 7 – Disclosure

At the point of adoption of IFRS 9, entities are also required to adopt amendments to IFRS 7 – 'Financial Instruments: Disclosures' made by IFRS 9 in July 2014. The principal amendments affecting the Company's accounts are those concerning the reporting of impairment, taking account of the IFRS 9 measurement requirements for impairment, the reporting of credit risk and the reporting of hedging strategies and outcomes.

This has, therefore, required significant amendments to the disclosures presented as notes, 13 (loans and impairment) and 14 (derivatives and hedging) in these accounts compared to those presented for the year ended 30 September 2018. When new notes address impairment, no comparative amounts are required to be disclosed, but for other new requirements, comparative amounts under the new standard at 30 September 2018 are shown.

Summary

The overall impacts of the changes above on consolidated equity at 30 September 2018 are set out below.

		£000	£000
Equity at 30 September 2018			9,850
IFRS 9			
Impairment	(note 13)	(2,001)	
Deferred tax thereon	(note 18)	339	
		(1,662)	
Total adjustments			(1,662)
Equity at 1 October 2018			8,188

All these amendments impacted retained earnings. None of these changes have any impact on the Company's cash flow reporting.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES

The particular accounting policies applied are described below.

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 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.

As described in note 20, since October 2010 the Company has the option, at any interest payment date, to repay all of its outstanding external borrowings at their carrying value at the time. In order for the call option to be exercised the directors must certify to the Trustee of the Notes that the Company will be able to repay all amounts due and payable on the interest payment date on which the option would take effect.

Such repayment would only take place in conjunction with the disposal of the Company's loan assets to a fellow group company and the effective cessation of its trade, followed by the orderly settlement of any remaining assets and liabilities and ultimately the dissolution of the Company. At the date of signing of these accounts no decision to exercise the option had been taken and there is no obligation for the Company to do so.

The existence of this option means that there is a material uncertainty as to whether the Company will continue to trade for the whole of the coming year and hence whether IAS1 would permit the use going concern basis of preparation.

Repayments of the principal liabilities of the Company, the mortgage backed floating rate notes described in note 20, are limited to available principal cash received on the Company's loan portfolio until the final repayment date. This, together with other structural features of the borrowing arrangements, gives the Company the ability to trade until the final repayment date, or until all the Notes are repaid in the normal course of business, if earlier, if the call option is not exercised. Therefore the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future and satisfy any liabilities which fall due.

On that basis, the directors have concluded that it is appropriate to continue to adopt the going concern basis in the preparation of these financial statements. However, the material uncertainty referred to above may cast significant doubt on the Company's ability to continue as a going concern and, therefore, to continue realising its assets and discharging its liabilities in the normal course of business.

In the paragraph above 'ability to continue as a going concern' is used as it is in IAS (UK) 570. The term 'ability to continue as a going concern' is equivalent to the term 'ability to adopt the going concern basis of accounting in the future'.

Loans to customers

Year ended 30 September 2019 under IFRS 9

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 EIR method. The loan balances are then reduced where necessary by a provision impairment.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Loans to customers (continued)

Year ended 30 September 2019 under IFRS 9 (continued)

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.

Year ended 30 September 2018 under IAS 39

Loans to customers are considered to be 'loans and receivables' as defined by International Accounting Standard 39 – 'Financial Instruments: Recognition and Measurement' ('IAS 39'). They are therefore accounted for on the amortised cost basis.

Such loans are valued at inception as the amount of initial advance, 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.

Thereafter they are valued at this amount less the cumulative amortisation calculated using the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by a provision for balances which are considered to be impaired.

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 expected future cash payments and receipts arising from the loan to the initial carrying amount.

The Company's policy is to hedge against any exposure to fixed rate loan assets (note 7).

Impairment of loans and receivables

Year ended 30 September 2019 under IFRS 9

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.

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; or
- 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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Impairment of loans and receivables (continued)

Year ended 30 September 2019 under IFRS 9 (continued)

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.

Year ended 30 September 2018 under IAS 39

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date in accordance with IAS 39. Where loans exhibit objective evidence of impairment (a 'loss event') the carrying value of the loans is reduced to the net present value of their expected future cash flows, including the value of the potential realisation of any security (net of sales costs) discounted at the original EIR.

Within its buy-to-let portfolio the Group 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. Properties in receivership are either returned to their landlord owners or sold.

Loss events reflect both loans that display delinquency in contractual payments of principal or interest or, for buy-to-let loans in receivership but up to date at the balance sheet date, properties where the receiver adopts a sale strategy, where a shortfall may or may not arise.

In addition to loans where loss events are evident, loans are also assessed collectively, grouped by risk characteristics and account is taken of any impairment arising due to events which are believed to have taken place but have not been specifically identified at the balance sheet date. Collective impairment provisions are calculated for each key portfolio based on recent historical performance, with adjustments for expected changes in losses based on management's judgement.

For financial accounting purposes provisions for impairments of loans to customers when first recognised in the income statement are held in an allowance account. These balances are released to offset against the gross value of the loan when it is written off to profit and loss on the administration system. After this point a salvage balance may be held in respect of any further recoveries expected on the loan.

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.

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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Deferred taxation

Deferred taxation is provided in full on temporary differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Deferred tax assets are recognised to the extent that it is regarded as probable that they will be recovered. As required by IAS 12 – 'Income Taxes', deferred tax assets and liabilities are not discounted to take account of the expected timing of realisation.

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 currency swaps and 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 7).

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.

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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Amounts owed by or to group companies

The balances owed by or to other group companies are carried at the current amount outstanding less any provision.

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.

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.

Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with International Accounting Standard 21 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company is pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of the transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with cash flow hedging provisions of IAS 39.

Deferred purchase consideration

Under the Mortgage sale agreement profits from the Company are paid up to the companies which originated the loans by way of deferred purchase consideration. Deferred purchase consideration is recognised in the period in which it becomes payable and is paid when sufficient cash resources allow. Mortgage Trust Services PLC and Paragon Finance PLC, to whom deferred purchase consideration is paid, are fellow group companies.

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

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.

5. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies set out in note 4 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.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision and the overall provision charge would be higher.

More information on the definition of SICR adopted is given in note 13.

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 13.

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; and
- 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.

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.

6. 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 significant of these 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.

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.

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.

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.

These assumptions are set out in note 13 where the sensitivity of the Company's modelling to them is also discussed.

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. For purchased accounts this will involve estimating the likely future performance of the accounts at the time of acquisition. These estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined.

6. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

Effective interest rates (continued)

The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and that predicted, which in turn would depend directly or indirectly on customer behaviour.

Fair values

Where financial assets and liabilities are carried at fair value, in the majority of cases this can be derived by reference to quoted market prices. Where such a quoted price is not available the valuation is based on cash flow models, based, where possible on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

7. FINANCIAL RISK MANAGEMENT

The Company's operations are financed principally by floating rate, asset backed loan notes and, to a lesser extent, by a mixture of share capital and loans from other group companies. The Company issues financial instruments to finance the acquisition of its portfolio of loans to customers and uses derivative financial instruments to hedge interest rate risk arising from fixed rate lending. 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 holding company reviews and agrees policies for all companies in the Group managing each of these risks and they are summarised below. These policies have remained unchanged throughout the year and since the year end.

Credit risk

The Company's credit risk is primarily attributable to its loans to customers. The maximum credit risk at 30 September 2019 approximates to the carrying value of loans to customers (note 12). There are no significant concentrations of credit risk due to the large number of customers included in the portfolios.

The Company acquired mortgages from Paragon Mortgages Limited and Mortgage Trust Services PLC, fellow group companies which place strong emphasis on good credit management at the time of underwriting new loans.

The acquired mortgages 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 originating lender. Additionally, each mortgage has 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 2019 67.6% of the Company's mortgage loans by value had a loan-to-value ('LTV') ratio of 70% or less. The weighted average LTV was 65.2%. LTV for each account is calculated by comparing the current balance to the most recent valuation of the mortgaged property, indexed as appropriate.

Paragon Finance PLC and Mortgages Trust Services PLC, fellow group companies, continues to administer the mortgages on behalf of Paragon Mortgages (No. 13) PLC 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 holding 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.

The terms of the debt issue require that the companies cash balances are held at institutions with a credit rating greater than P-1 by Moody's and/or A-1 by Standard and Poors and/or F1 by Fitch Ratings.

Liquidity risk

The Company's assets are principally financed by asset backed loan notes issued through the securitisation process. Details of the Company's borrowings are given in notes 19 and 20. Securitisation effectively eliminates the Company's liquidity risk by matching the maturity profile of the Company's funding to the profile of the assets to be funded.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

7. 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 swap agreements.

The rates payable on the asset backed loan notes issued by the Company are reset quarterly on the basis of LIBOR, USD LIBOR or EURIBOR. 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 are 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.

In part, the Company's interest rate hedging objectives are achieved by the controlled mismatching of the dates on which instruments mature, redeem or have their interest rates reset.

Currency risk

All of the Company's assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in euros and US dollars, described in note 20. Although IAS 39 requires that they be accounted for as currency liabilities and valued at their spot rates, it was a condition of the issue of these notes that the interest rate and currency swaps were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR linked floating rate sterling borrowing. As a result the Company has no material exposure to foreign currency risk.

The equivalent sterling principal amounts of notes in issue under these arrangements, and their carrying values at 30 September 2019 and 30 September 2018 are:

	2019 Equivalent sterling principal £000	2019 Carrying value £000	2018 Equivalent sterling principal £000	2018 Carrying value £000
US dollar notes	76,271	117,301	82,057	119,042
Euro notes	191,864	253,560	203,920	270,765

Use of derivative financial instruments

The Company uses derivative financial instruments for risk management purposes. Such instruments are 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 year 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 and borrowings denominated in foreign currencies. 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 has also designated cash flow hedging relationships, principally arising from currency borrowings, where a specified foreign exchange basis swap, set up as part of the terms of the borrowing is used.

7. FINANCIAL RISK MANAGEMENT (CONTINUED)

Fair values of financial assets and financial liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate. The principal inputs to these valuation models are LIBOR benchmark interest rates for the currencies in which the instruments are denominated, sterling, euros and dollars. The cross currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. In order to determine the fair values the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. Details of these assets are given in note 14.

8. INTEREST PAYABLE AND SIMILAR CHARGES

	2019 £000	2018 £000
Asset backed loan notes	8,973	7,359
Subordinated loan interest	1,377	1,309
Interest payable to group companies	144	178
	10,494	8,846

9. DIRECTORS AND EMPLOYEES

Directors' fees from the Company during the year is stated in note 10.

The Company had no employees in the current or preceding year. All administration is performed by employees of the Group. The directors of the Company, with the exception of J Fairrie and P H Whitaker, are employed by Paragon Finance PLC, a fellow group company, and their remuneration is disclosed within the financial statements of that company, which do not form part of this Report.

10. OPERATING LOSS, BEING LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION

	2019 £000	2018 £000
Operating loss is after charging:		
Directors' fees	3	3
Auditor remuneration - audit services	10	8
Deferred purchase consideration	7,506	7,447

Non audit fees provided to the Group are disclosed in the accounts of the parent company 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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

11. TAX ON LOSS ON ORDINARY ACTIVITIES

a) Tax credit for the year

	2019 £000	2018 £000
Current tax		
Corporation tax	27	15
Total current tax	27	15
Deferred tax (note 18)		
Origination and reversal of timing differences	(364)	(295)
Rate change	(187)	-
Total deferred tax	(551)	(295)
Tax charged on profit on ordinary activities	(524)	(280)

b) Factors affecting the tax credit for the year

	2019 £000	2018 £000
Loss before tax	(1,774)	(1,474)
UK corporation tax at 19% (2018: 19%) based on the loss for the year	(337)	(280)
Effects of:		
Change in rate of taxation on deferred tax balances	(187)	-
Tax charge for the year	(524)	(280)

The current rate of corporation tax applicable to the Company for the year ended 30 September 2019 is 19.0%. Legislation has been enacted that will reduce this to 17% with effect from 1 April 2020.

Therefore, the effective rate of corporation tax is expected to be 18% for the year ending 30 September 2020 and 17% thereafter. The deferred tax liability reflects the rate at which temporary differences are expected to reverse.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

12. FINANCIAL ASSETS

	2019 IFRS 9 £000	2018 IFRS 9 £000	2018 IAS 39 £000
Loans to customers (note 13)	710,098	761,845	763,846
Derivative financial assets (note 14)	102,666	103,576	103,576
	812,764	865,421	867,422

13. 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 12, 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

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').

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.

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Company's most significant asset classes. 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. 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.

In certain asset classes a fully modelled approach is not possible. This is generally where there are few assets in the class, where there is insufficient historical data on which to base an analysis or where certain measures, such as days past due are not useful. In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal credit monitoring practices and professional credit judgement.

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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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 in its modelled portfolios 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 will future economic expectations.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR.

The Company uses arrears multiples as a proxy for days past due, as this measure is commonly used in its arrears reporting. A loan will generally be one month in arrears from the point it is one day past due until it is thirty days past due.

Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The Company's definitions of default for its various portfolios are aligned to its internal operational procedures and the regulatory definitions of default used internally. 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.

IFRS 9 provides a rebuttable presumption that an account is in default when it is ninety days overdue and this was used as the basis of the Company's definition. A combination of qualitative and quantitative measures were used in developing the definitions. These include account management activities and internal statuses.

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.

During the year the Company revised certain of its default definitions for regulatory purposes. Where appropriate, IFRS 9 definitions have been amended to harmonise with the new definition and hence the staging at 1 October 2018.

As a result of this harmonisation 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 ninety days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

IFRS 9 Staging

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

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.

Impairments by stage

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 2019				
Gross loan book	649,171	44,046	18,901	712,118
Impairment provision	(75)	(268)	(1,677)	(2,020)
Net loan book	649,096	43,778	17,224	710,098
Coverage ratio	0.01%	0.61%	8.87%	0.28%

	Stage 1	Stage 2 *	Stage 3 *	Total
	£000	£000	£000	£000
1 October 2018				
Gross loan book	697,448	48,629	19,849	765,926
Impairment provision	(20)	(249)	(3,812)	(4,081)
Net loan book	697,428	48,380	16,037	761,845
Coverage ratio	0.00%	0.51%	19.21%	0.53%

* Stage 2 and 3 balances are analysed in more detail below.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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.

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, which are automatically deemed to have an SICR.

	< 1 month arrears	**> 1 <= 3 months arrears**	**Total**
	£000	**£000**	**£000**
30 September 2019			
Gross loan book	40,129	3,917	44,046
Impairment provision	(235)	(33)	(268)
Net loan book	39,894	3,884	43,778
Coverage ratio	0.58%	0.86%	0.61%
1 October 2018			
Gross loan book	39,078	9,551	48,629
Impairment provision	(68)	(181)	(249)
Net loan book	39,010	9,370	48,380
Coverage ratio	0.17%	1.89%	0.51%

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between accounts in the process of enforcement or where full recovery is considered unlikely ('Realisations' in the table), loans being managed on a long term basis where full recovery is possible but which are considered in default for regulatory purposes and buy-to-let mortgages where a receiver of rent ('RoR') has been appointed by the Company to manage the property on the customer's behalf. RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

	> 3 month arrears £000	RoR managed £000	Realisations £000	Total £000
30 September 2019				
Gross loan book	640	18,088	173	18,901
Impairment provision	(11)	(1,666)	-	(1,677)
Net loan book	629	16,422	173	17,224
Coverage ratio	1.64%	9.21%	0.00%	8.87%
1 October 2018				
Gross loan book	347	17,340	2,162	19,849
Impairment provision	-	(2,457)	(1,355)	(3,812)
Net loan book	347	14,883	807	16,037
Coverage ratio	0.00%	14.17%	62.67%	19.21%

The exposure at default in the calculation shown above for stage 3 accounts is reduced by £8,684,000 in respect of the value of security given by customers. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure value in the central economic scenario. Security values are based on the most recent valuation of the relevant property held by the Company, indexed as appropriate.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. 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.

	Total
	£000
At transition – 1 October 2018	4,081
Recovered in period	(2,409)
Amounts written off	327
At 30 September 2019	1,999

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 2019 enforceable contractual balances of £1,606,000 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 on a consolidated basis for the year ended 30 September 2019 is set out below.

	Stage 1	Stage 2 *	Stage 3 *	Total
	£000	£000	£000	£000
Loss allowance at 1 October 2018	20	249	3,812	4,081
New assets originated or purchased	-	-	-	-
Changes in loss allowance				
Transfer to stage 1	23	(23)	-	-
Transfer to stage 2	(1)	1	-	-
Transfer to stage 3	-	(1)	1	-
Changes due to credit risk	33	42	(433)	(358)
Write offs	-	-	327	327
Assets recognised	-	-	-	-
Changes in models/parameters	-	-	(2,030)	(2,030)
Loss allowance at 30 September 2019	75	268	1,677	2,020

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. 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 2018	697,448	48,629	19,849	765,926
New assets originated or purchased	-	-	-	-
Changes in staging				
Transfer to stage 1	14,200	(14,200)	-	-
Transfer to stage 2	(16,683)	16,820	(137)	-
Transfer to stage 3	(573)	(1,412)	1,985	-
Redemptions and repayments	(43,707)	(5,686)	(1,113)	(50,506)
Assets derecognised	-	-	-	-
Write offs	-	-	327	327
Other changes	(1,514)	(105)	(2,010)	(3,629)
Balance at 30 September 2019	649,171	44,046	18,901	712,118
Loss allowance	(75)	(268)	(1,677)	(2,020)
Carrying value	649,096	43,778	17,224	710,098

Impairments charged to income

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

	2019 IFRS 9 £000	2018 IAS 39 £000
Recovered / provided in period	(2,409)	(1,379)
Written off amounts	1,948	1,205
	(461)	(174)

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. The Company uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

In developing its economic scenarios, the Company considers analysis from reputable external sources to form a general market consensus which inform its central scenario. These sources included forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies.
The central scenario is the economic forecast used within the Company for planning purposes and represents its expectation of the most likely outcome. The upside and downside scenarios are less likely variants developed from this base case. The final scenario represents a protracted slump and is derived from the Bank of England's annual stress testing scenarios. 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 Company and must be consistent.
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 2019

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	*40%*	*20%*	*35%*	*5%*
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.7%	2.2%	1.0%	(0.1)%
House Price Index ('HPI') (increase)	3.3%	5.5%	(0.1)%	(5.3)%
Bank Base Rate ('BBR')	0.8%	1.9%	0.5%	0.0%
Consumer Price Inflation ('CPI')	2.1%	1.8%	2.5%	3.1%
Unemployment (rate)	3.9%	3.5%	5.6%	8.0%
Secured lending (annual change)	3.6%	4.2%	2.7%	1.4%
Consumer credit (annual change)	6.1%	7.6%	3.8%	0.3%

1 October 2018

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	*40%*	*30%*	*25%*	*5%*
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.6%	2.0%	0.9%	(0.1)%
House Price Index ('HPI') (increase)	3.0%	5.1%	(0.3)%	(5.2)%
Bank Base Rate ('BBR')	1.2%	1.7%	0.7%	0.0%
Consumer Price Inflation ('CPI')	2.1%	1.8%	2.6%	3.3%
Unemployment (rate)	3.9%	3.6%	5.7%	8.3%
Secured lending (annual change)	3.2%	3.6%	2.5%	1.5%
Consumer credit (annual change)	8.6%	10.5%	5.3%	0.6%

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

14. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

The Company uses derivative financial instruments such as cross-currency basis swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk (as described in note 7) and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

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 are cash flow hedges, which are used to manage the foreign exchange and interest rate basis risk inherent in its currency borrowings.

The analysis below shows the cash flow hedges. There were no individual interest rate risk hedging arrangements in place either in the year ended 30 September 2019 or the preceding year.

	2019 Assets £000	2019 Liabilities £000	2018 Assets £000	2018 Liabilities £000
Derivatives in accounting hedge relationships				
Cash flow hedges				
Cross-currency basis swaps				
Dollar-sterling	40,930	-	36,832	-
Euro-sterling	61,736	-	66,744	-
Total recognised derivative assets / (liabilities)	102,666	-	103,576	-

The credit risk inherent in the derivative financial assets shown above is discussed in note 7.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

14. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Cash flow hedging

Background and hedging objectives

The Company has entered into cross-currency basis swap agreements which form part of its securitisation arrangements, providing an economic hedge against financial risks inherent in the deal structures, as described below. Such relationships have been designated as cash flow hedges for accounting purposes.

In any securitisation where asset backed floating rate notes are issued in currency (US dollars or euros), a currency and interest rate mismatch between assets and liabilities would exist, exposing the securitisation and the Company to both foreign exchange and interest basis risk.

This would preclude such a deal from attaining a AAA rating for its senior debt. To address that issue, in each deal a bespoke cross currency basis swap was written, with the swap being an asset or liability of the relevant SPV company.

The effect of these swaps is to translate the required currency payments, both of principal and interest to sterling payments, based on a fixed rate of exchange. They also translate the reference rate of interest on the notes from a dollar or euro LIBOR basis to a sterling LIBOR basis. This effectively eliminates the foreign exchange and interest rate basis risks with respect to these instruments.

In order to achieve a AAA rating for the deal, the swaps must themselves be capable of this level of rating. Therefore, the deal conditions specify that only high quality counterparties may be used, and that where there is deterioration in credit quality of the counterparty, collateral must be posted. The collateral requirement is supervised by the independent third-party trustees of the notes.

Hedging instruments

Under these swap agreements

- the Company will make quarterly payments of principal and floating rate interest in sterling and receive equivalent amounts of principal and floating rate interest, in currency (either US Dollars or Euros), translated at an exchange rate fixed on inception.
- Settlement of both the cross-currency basis swaps and the notes to which they relate takes place on the same date. The Company makes a single payment in sterling to the swap provider who will make the corresponding swap payment in currency to the external principal paying agent. The principal paying agent will use these funds immediately to make the payments required on the currency notes.
- the nominal amount of the swaps is adjusted automatically, quarter by quarter, such that it always amortises in line with the quarterly payments of principal made on the currency notes (a 'balance guarantee' feature)
- Floating rate interest on the sterling (pay) leg of the swaps is set with reference to three-month sterling LIBOR, with floating rate interest on the currency (receive) legs set by reference to equivalent currency rates
- The payment and repricing dates are the same (to the day) for the swaps as for their underlying notes
- The swaps must remain in place for as long as the notes are outstanding

14. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

The principal terms of the hedging instruments (the cross currency basis swaps) are summarised below.

	2019		2018	
	Swap currency		Swap currency	
	USD	EUR	USD	EUR
Average fixed exchange rate	1.88	1.49	1.88	1.49
Average margin over LIBOR on interest payable (bp)	0.25%	0.46%	0.25%	0.46%
Average margin over US dollar LIBOR / EURIBOR on interest receivable (bp)	0.18%	0.42%	0.18%	0.42%
Notional Principal value (£000)	76,271	191,864	82,057	203,920
Fair value (£000)	40,930	61,736	36,832	66,744
Average remaining term (years)	20	20	21	21

The current long term credit rating of the swap counterparty issued by Fitch ratings is AA- (2018: AA-) and £nil (2018: £nil) of collateral has been posted. This collateral is not included in the company's balance sheet.

Although the average remaining contractual term is as shown above, the link between the notional principal of the swaps and the balance outstanding on the Notes means that the life may, in practice, be much shorter.

In normal conditions the market values of such swaps would be expected to be relatively small. However, the majority of such swaps in the Company date from before the 2008 credit crisis, when a major dislocation in rates occurred, creating significant market value in the instruments. However, economically, this is offset by the corresponding increase in the carrying value of the currency denominated notes.

Sources of potential ineffectiveness

All cross-currency basis swap agreements have been designated as cash flow hedges in line with their economic effect and the critical terms, such as interest and exchange rates, pricing dates and principal balances of the designated hedging instruments exactly match those of the hedged currency denominated Floating Rate Notes ('FRNs'). This results in a critical terms match for IAS 39 purposes and hence no ineffectiveness could arise from sources other than credit risk.

In respect of credit risk the hedging instruments are partially collateralised, with additional collateral conditionally available, as described in note 7. This generates a small potential credit valuation adjustment associated with the derivative asset representing the credit risk of the receivable future cash flows that make up the derivative fair value. However, IAS 39 requires that Other Comprehensive Income ('OCI') is adjusted by the lower of the cumulative gain or loss on the derivative or the hedged item (as proxied by a hypothetical derivative). As the derivative bears credit risk of the counterparty (for the uncollateralised portion) it has a lower fair value than the hypothetical derivative. The result is that the full fair value of the derivative is taken to OCI as it is the lower of the two amounts and no ineffectiveness arises.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

14. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

Accounting impacts

Movements affecting the cash flow hedge relationships in the year are set out below.

	2019 Swap currency		2018 Swap currency	
	USD	EUR	USD	EUR
Hedging Items				
Cross-currency basis swaps				
Included in derivative financial assets	40,930	61,736	36,832	66,744
Included in derivative financial liabilities	-	-	-	-
	40,930	61,736	36,832	66,744
Notional principal value	76,271	191,864	82,057	203,920
Change in fair value used in calculating hedge ineffectiveness	9,069	(3,541)	4,876	820
Hedged Items				
Floating rate notes				
Included in Asset Backed Loan Notes	76,271	191,864	82,057	203,920
Changes in fair value used in calculating hedge ineffectiveness	9,069	(3,541)	4,876	820
Cash flow hedging reserve	63	538	18	415

The table below summarises the amounts which have affected total comprehensive income as a result of the cash flow hedges described above.

	2019 £000	2018 £000
Change of value in hedging instrument recognised in cash flow hedge reserve		
US Dollars swaps	9,069	4,876
Euro swaps	(3,541)	820
	5,528	5,696
Amount reclassified from cash flow hedge reserve to profit, recognised as foreign exchange differences and interest on asset backed loan notes within interest payable		
US Dollars swaps	9,114	4,883
Euro swaps	(3,418)	830
	5,696	5,713
Net amount recognised in Other Comprehensive Income before tax	168	17

All amounts reclassified to profit have been transferred because the hedged item has affected profit or loss.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

15. DEBTORS

	2019 £000	2018 £000
Amounts falling due within one year:		
Amounts due from group companies	306	140
Prepayments and accrued income	52	50
	358	190

16. CALLED UP SHARE CAPITAL

	2019 £	2018 £
Allotted:		
49,998 ordinary shares of £1 each (25p called up and paid)	12,500	12,500
2 ordinary shares of £1 each (fully paid)	2	2
	12,502	12,502

17. RESERVES

	Profit and loss account £000	Cash flow hedging reserve £000	Total reserves £000
At 1 October 2017	10,681	337	11,018
Loss for the financial year	(1,194)	-	(1,194)
Movement in fair value of hedging derivatives net of tax	-	14	14
At 30 September 2018	9,487	351	9,838
Loss for the financial year	(1,250)	-	(1,250)
Movement in fair value of hedging derivatives net of tax	-	122	122
Change in accounting policy on adoption of IFRS9	(1,662)	-	(1,662)
At 30 September 2019	6,575	473	7,048

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

18. PROVISIONS FOR LIABILITIES

Deferred tax

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

	2019 £000	2018 £000
Balance at 1 October 2018	2,219	2,511
Charge to equity	45	3
Profit and loss credit (note 11)	(364)	(295)
Rate change (note 11)	(187)	-
Change in accounting policy on adoption of IFRS9 (note 3)	(339)	-
Balance at 30 September 2019	1,374	2,219
The net deferred tax liability for which provision has been made is analysed as follows:		
Other timing differences	1,374	2,219

19. CREDITORS

	2019 £000	2018 £000
Amounts falling due within one year:		
Amounts due to group companies	6,283	5,327
Corporation tax	27	15
Accruals and deferred income	2,878	2,620
	9,188	7,962

Included with the accruals and deferred income balance is an amount of £839,000 (2018: £872,000) due to fellow subsidiaries of Paragon Banking Group PLC .

	2019 £000	2018 £000
Amounts falling due after more than one year:		
Asset backed loan notes	711,804	761,666
Asset backed loan notes – fair value adjustment	102,065	103,143
	813,869	864,809
Intercompany subordinated loan	28,504	28,504
	842,373	893,313

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

19. CREDITORS (CONTINUED)

The Company's securitisation borrowings are denominated in sterling, US dollars and euros. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with all foreign currency swaps, although the credit balance is compensated for by retranslating the borrowings at the current exchange rate. A maturity analysis and further details of the asset backed loan notes are given in note 20.

20. BORROWINGS

The mortgage backed floating rate notes are secured over a portfolio comprising variable rate mortgage loans secured by first charges over residential properties in the United Kingdom. The notes are subject to mandatory redemption in part on each interest payment date in an amount equal to the principal received or recovered in respect of the mortgage. As a result of this structure, cash received in respect of loan assets is not immediately available for distribution. At 30 September 2019, the amount of restricted cash and investments held within the Company was £46,873,000 (2018: £45,732,000). The maturity date of the notes matches the maturity date of the underlying assets. It is likely that a substantial proportion of these notes will be repaid within five years.

The Company had the option to repay all of the notes at an earlier date (the 'call date'), or at any interest payment date thereafter, at the outstanding principal amount.

Interest is payable at a fixed margin above:

- the London Interbank Offered Rate ('LIBOR') on notes denominated in sterling;
- the London Interbank Offered Rate ('US Dollar LIBOR') on notes denominated in US dollars; and
- the Euro Interbank Offered Rate ('EURIBOR') on notes denominated in euros.

All payments in respect of the notes are required to be made in the currency in which they are denominated.

Notes in issue at 30 September 2019 and 30 September 2018 were:

Notes	Maturity date	Call date	Principal outstanding 2019	Principal outstanding 2018	Note margin 2019	Note margin 2018
			£m	£m		
'A1a'	Jan 2039	Oct 2010	326.9	351.7	0.24%	0.24%
'A2a'	Jan 2039	Oct 2010	51.2	55.1	0.24%	0.24%
'B1a'	Jan 2039	Oct 2010	53.2	56.0	0.40%	0.40%
'C1a'	Jan 2039	Oct 2010	12.4	13.0	0.80%	0.80%
			$m	$m		
'A2c'	Jan 2039	Oct 2010	143.4	154.3	0.18%	0.18%
			€m	€m		
'A2b'	Jan 2039	Oct 2010	129.1	138.8	0.24%	0.24%
'B1b'	Jan 2039	Oct 2010	79.8	84.0	0.38%	0.38%
'C1b'	Jan 2039	Oct 2010	77.0	81.0	0.78%	0.78%

All of the above notes are listed on the main market of the London Stock Exchange.

There is a subordinated loan facility under which an amount was drawn down by the Company to establish the first loss fund, which is repayable to Paragon Finance PLC and Mortgage Trust Services PLC on the earlier of the last interest payment date in January 2039 or the first day on which there are no notes outstanding, except that on any interest payment date sums borrowed will be repaid to the extent of any amount released from the first loss fund. Interest is payable at the rate of 4% above the London Interbank Offered Rate for three month sterling deposits.

There are no amounts of committed but undrawn facilities at 30 September 2019 and September 2018.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

21. ULTIMATE PARENT COMPANY

The smallest and largest group into which the Company is consolidated, and the Company's immediate and ultimate parent company and ultimate controlling party is Paragon Banking Group PLC, a company registered in England and Wales.

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