Company Registration No: 01917566

PARAGON FINANCE PLC

Report and Financial Statements

Year ended 30 September 2017

STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

Paragon Finance PLC ('the Company') is a wholly owned subsidiary of Paragon Bank PLC which is a wholly owned subsidiary of Paragon Banking Group PLC ('the Group'). During the year the Company operated in the United Kingdom. The principal activities of the Company are the provision of administration and other management services to other group companies and as an investor in special purpose vehicle companies issued by other members of the Group.

The Company undertakes loan servicing and customer management on behalf of all of the Group's operating companies and certain third parties. To undertake these tasks it holds the Group's fixed assets, other than property, owns the rights to all of its infrastructure and intellectual property and employs the vast majority of the Group's people. There have been no significant changes in the Company's principal activities in the year under review and 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.

During the preceding year, the Company obtained permission from the Financial Conduct Authority (FCA), for regulatory permission relating to its consumer credit regime. The Company also holds the requisite permission from the FCA to administer both second and first charge residential mortgages. The company's registration in relation to the administration of consumer Buy to Let loans was also confirmed by the FCA.

During the year the Company's share capital was acquired by Paragon Bank PLC.

As shown in the Company's profit and loss account on page 15, the Company's net interest income decreased from £3,710,000 to £2,802,000. The main driver for interest income falling was due to the return on pension scheme liabilities increasing from £783,000 to £1,359,000. The subordinated loans decreased by 24% (2016: 1% increase) principally due to securitisation mortgage loans being sold to fellow group companies in the year, therefore the subordinated loans were repaid. Interest charged on the subordinated loans provided to other group companies and related parties decreased. The provision on loans to other group companies was £6,332,000 (2016: £425,000) due to the effects of trading between group companies and a decrease in reserves of those companies. The release of provision on loans to related parties was £1,110,000 (2016: provision of £543,000) due to the effects of trading between these entities and an increase in reserves of those companies. The release of provision on investment in group companies was £2,120,000 (2016: £1,538,000) due to the effects of trading between group companies and an increase in reserves of those companies. Therefore, in the current year there was a provision charge compared to a release of provision for the preceding year. Other operating income has decreased from £103,604,000 to £102,726,000 due to a decrease in the deferred consideration received. The net income from deferred consideration received and management costs recharged to other Group entities decreased during the year to £80,077,000 from £83,116,000. As a result of the above, operating profit before taxation has fallen from £32,904,000 to £19,668,000, and the profit after tax has decreased from £25,695,000 to £15,474,000.

The balance sheet on page 16 of the Financial Statements shows the Company's financial position at the year end. Net assets have increased by 40% (2016: 1% decrease) due to the net effect of the profit for the year and actuarial gain on the pension fund. Details of amounts owed from and to other group companies are shown in notes 22 and 26.

No interim dividend was paid during the year (2016: £nil). No final dividend is proposed (2016: £nil).

The Company has entered into derivative contracts in order to provide an economic hedge against its exposure to fixed rate loans to customers of other group companies. Although these instruments provide an economic hedge the prescriptive nature of the requirements of International Accounting Standard 39 – 'Financial Instruments: Recognition and Measurement' ('IAS 39') means that hedge accounting cannot always be achieved. This has led to the Company recognising a fair value net loss of £1,000 in the year (2016: £1,000) due to the ineffectiveness of the hedge relationship. This represents a timing difference and cumulative gains and losses recognised will tend to be zero over time.

The Group manages its operations on a centralised basis and compiles its management information, including key performance indicators, on a consolidated basis. This consolidated information is used in controlling the operations of the Company, which provides services to all Group entities. Given the pervasive involvement of the Company in the Group's activities, the Company's directors believe that further key performance indicators for the Company, compiled on a stand-alone basis, are not necessary or appropriate to provide an understanding of the development, performance or position of the Company's business. Details of the Group's financial performance, including key performance indicators, are given in the Annual Report of its parent company, which does not form part of this Report.

STRATEGIC REPORT (CONTINUED)

OUTLOOK

As part of the Group's wider strategy to enter the first charge residential mortgage market, the Company, as the Group's principal servicing business, now holds the requisite permission from the FCA to administer both second and first charge residential mortgages. As the Group's activities in these areas expand the Company's administration activities will also grow, but no major changes in the nature of its activities are expected in the coming year.

PRINCIPAL RISKS AND UNCERTAINTIES

An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out on pages 4 to 10 and in note 4. A discussion of critical accounting estimates is set out in note 3.

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 supported by the Group holding sufficient cash resources to support the Company's obligations as they fall due. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

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.

EMPLOYEES' INVOLVEMENT

The directors recognise the benefit of keeping employees informed of the progress of the business. Employees have been provided with regular information on the performance and plans of the Company and the financial and economic factors affecting it, through both information circulars and management presentations.

The Company participates in a Sharesave share option scheme and a profit sharing scheme, both of which enable eligible employees to benefit from the performance of the business.

The directors encourage employee involvement at all levels through the staff appraisal process and communication between directors, managers, teams and individual employees.

EMPLOYMENT OF DISABLED PERSONS

Full and fair consideration is given to applications for employment made by disabled persons having regard to their particular aptitudes and abilities. The Company has continued its policy of providing appropriate training and career development to such persons.

Approved by the Board of Directors

and signed on behalf of the Board

K G Allen

Director

23 January 2018

STRATEGIC REPORT (CONTINUED)

CAUTIONARY STATEMENT

Sections of this Annual Report, including but not limited to the Directors' Report and the Strategic Report may contain forward-looking statements with respect to certain plans and current goals and expectations relating to the future financial condition, business performance and results of Paragon Finance PLC. These have been made by the directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Paragon Finance PLC and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

PRINCIPAL RISKS AND MITIGATION

The Company is exposed to a number of principal risks and uncertainties that arise from the operation of its business model and strategy. The Company derives almost all of its income from the provision of finance, facilities and services to other Group companies. Its performance would therefore be materially either directly or indirectly affected by any downturn in the performance of the Group resulting from a crystallisation of any of the risks to which the Group is exposed. Therefore the risks to which the Company is exposed are the same as those for the Group as a whole.

A summary of those risks and uncertainties which could prevent the achievement of the Company's strategic objectives, how the Company seeks to mitigate those risks and the change in the perceived level of each risk in the last financial year are described below.

This summary should not be regarded as a complete statement of all potential risks and uncertainties faced by the Company but rather those which the Company believes have the potential to have a significant impact on its financial performance and future prospects.

To identify and control the risks to which it is exposed, the Group employs a risk management framework. As part of this framework, principal risks are identified and assessed within the key categories of Business Risk, Credit Risk, Conduct Risk, Operational Risk, Liquidity and Capital Risk, Market Risk, and Pension Obligation Risk.

Further information concerning the systems used to manage risk by the Group are included in section B6.4 of the Annual Report and Accounts of the parent company.

Changes in risks are identified as shown below:

	Risk increasing		Risk decreasing		Risk stable

Business Risk

Economic Risk

Description	Mitigation
The Group could be materially affected by a severe downturn in the UK economy given its income is wholly derived from activities within the UK. This is more difficult to forecast given current uncertainties on the terms on which the UK will leave the EU in March 2019. This could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.	The Group closely monitors economic developments in the UK and overseas, with support from leading independent macro-economic advisors. This information supports the senior management's annual review of strategic objectives and business plans for each of the Group's principal trading operations. As a lender and acquirer of credit portfolios inevitably exposes the Group to any material deterioration in economic conditions, the Board's defined strategy is to limit this risk by operating as a specialist lender in carefully chosen markets where its employees have significant levels of experience and expertise. A robust stress testing framework is maintained which provides the Board with an informed understanding and appreciation of the Group's capacity to withstand shocks of varying severities.

Change	Whilst UK economic performance has remained broadly stable in the last financial year, given the heightened level of economic and political uncertainty, the overall risk assessment is considered to have increased in the last year.	

PRINCIPAL RISKS AND MITIGATION (Continued)

Business Risk

Concentration risk

Description	Mitigation
The Group is heavily reliant on lending to customers investing in the UK private rented sector. It is therefore exposed to any deterioration in performance of the sector, which will be influenced by factors such as house prices, supply of rental property, fiscal and regulatory intervention and demographic changes.	The Group has a very deep understanding of the private rented sector built up over many years of successful operations in the buy-to-let market. This includes a long history of performance data through the economic cycle. It seeks to use this expertise constructively by playing an active role through several routes, in shaping the development of policy for the private rented sector. Given its deep specialist knowledge of the sector and its historically prudent approach to underwriting, the Group has been well placed to respond promptly and effectively to recent regulatory changes relating to buy-to-let lending The Group also continues to exploit opportunities to diversify the range of its activities and income streams, consistent with its strategic objective of operating as a prudent, risk focussed specialist lender. This has been illustrated in recent years through acquisitions and diversification into new product areas.

Change	The Group continues to have significant exposure to buy-to-let lending but is confident in its ability to operate successfully in this evolving environment. It has therefore assessed the overall risk resulting from its reliance on the buy-to-let exposure in the last 12 months as stable.	

Transition risk

Description	Mitigation
Failure to effectively manage the transition and implementation risks resulting from the recent major internal reorganisation undertaken and the acquisitions of two asset finance businesses could impact adversely on the Group's financial performance and its reputation.	The corporate reorganisation has been managed through a formal project governance programme involving key executives chaired by the CFO reporting to the Board. Extensive proactive engagement has been undertaken with relevant regulatory bodies and detailed advice provided by leading legal and accountancy firms. In relation to the Board's M&A strategy, the Group will only consider acquisitions in areas of business that it understands and which are complementary to its existing activities. Formal governance arrangements are applied to any proposed acquisition and to subsequent integration projects, with regular progress reporting to the executive team and the Board.

Change	The recent corporate reorganisation and the continuing integration activity relating to prior year acquisitions has inevitably led to a potential for exposure to greater risk in this area during the reporting period.	

PRINCIPAL RISKS AND MITIGATION (Continued)

<table>
<tr><th colspan="3">Credit Risk</th></tr>
<tr><td colspan="3">Customer Risk</td></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>As a lender, failure to target and underwrite credit decisions effectively could result in customers becoming less able to service debt, exposing the Group to unexpected material losses.

Recoverable amounts on loans may also be affected by adverse movements in security values such as house and commercial asset prices.</td><td colspan="2">The Group has comprehensive policies in place that set out detailed criteria which must be met before loans are approved.

Credit policies incorporate limits for concentration risks arising from factors such as large exposures to counterparties, geographical areas or types of lending.

The Group uses a range of sources to inform expectations of key external factors such as interest rate movements and house price inflation which are in turn used to guide policy and underwriting.

The Group's approach to the management of credit risk and the systems in place to mitigate that risk on both originated and purchased assets are further described in note 4 to the accounts.</td></tr>
<tr><td>Change</td><td>The Group's impairment rate has remained very low, reflecting the maintenance of robust, proven credit disciplines, generally stable economic conditions and the credit quality of its borrowers.</td><td>↔</td></tr>
<tr><td colspan="3">Counterparty Risk</td></tr>
<tr><th>Description</th><th colspan="2">Mitigation</th></tr>
<tr><td>Failure of an institution holding the Group's cash deposits or providing hedging facilities for risk mitigation could expose the Group to loss or liquidity issues.</td><td colspan="2">The Group has a strictly controlled number of approved treasury counterparties. To be approved, counterparties must meet specific credit rating criteria.

Exposure to approved counterparties is monitored intra-day by senior management within the Group's Treasury function with all trading performed within approved limits.

The credit quality of all treasury counterparties and the Group's exposure to them is reported monthly to ALCO.

Treasury counterparties are typically highly rated banks and, for all cash deposits and derivative positions held within the Group's securitisation structures, they must comply with criteria set out in the financing arrangements, which are monitored externally.</td></tr>
<tr><td>Change</td><td>The credit quality of the treasury counterparties, with whom the Group transacts has been maintained during the year and this risk is therefore considered to be stable.</td><td>↔</td></tr>
</table>

PRINCIPAL RISKS AND MITIGATION (Continued)

Conduct Risk

Customer Fair Outcomes

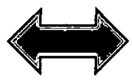
Description	Mitigation
The Group provides a broad range of financial services products across a number of brands to consumers and small business customers. As a result, the Group is exposed to potential conduct risk should it fail to deliver fair outcomes for its customers. Systemic poor customer treatment may lead to regulatory censure, reputational damage.	The Group's Conduct Risk Policy sets out the conduct risk framework requirements within which business areas are required to develop systems and processes to identify, measure, manage, monitor and report risks in accordance with stated risk appetites. Underpinning this Policy are additional policies and standards to ensure the fair treatment of customers such as; complaint handling, responsible lending, sales and distribution practices, forbearance, and vulnerable customer treatment. Business areas dealing with consumers have dedicated Quality and Control teams which validate process adherence and the delivery of fair treatment for customers. The Group's Compliance function provides oversight by way of their monitoring plan which is heavily focused on conduct risk and the fair treatment of customers. All employees are required to undertake conduct risk related training and, where appropriate, staff receive additional focused training on a variety of customer centric topics.

Change	The increasingly regulated nature of the Group's operations and continuing changes to the regulatory conduct landscape heightens the potential risk.	

Operational Risk

People Risk

Description	Mitigation
The Group is exposed to the risk that it is unable to recruit and retain skilled senior management and key personnel at all levels. Failure to maintain the necessary skill base within its workforce could have a material impact on the Group's ability to deliver its business plan and strategic objectives. This is a particular risk in respect of key specialist and executive positions, where the institutional knowledge of the incumbents would be hard to replicate in the short term.	The Group manages and controls its key person dependency risk through effective succession planning, recruitment, development and retention strategies. External remuneration and reward structures are monitored to ensure it remains competitive and is able to recruit and retain key personnel; A range of employee benefits are offered in addition to base salaries including a defined contribution pension scheme, Sharesave Plan and an annual profit related performance scheme for most employees Manager and Team Leader Academies are employed to develop pools of strong, capable individuals with the potential to fill future managerial and specialist roles within the business. The Group has been accredited under the 'Investors in People' scheme since 1997 and retains the Champion status which it achieved in 2014.

Change	During the last year, a strong employment market and buoyant demand for skilled financial services staff has led to greater competition. Despite this, the Group remains confident in its ability to manage this risk.	

PRINCIPAL RISKS AND MITIGATION (Continued)

Operational Risk

Systems Risk

Description	Mitigation
The Group is exposed to the risk that its IT infrastructure and systems are unable to support its operational needs and fail to offer adequate protection against the threat of cyber-crime. This risk also includes the potential that the Group's key outsourcing arrangements with third parties could expose it to material loss or reputational damage.	During the course of the year, the Group has further strengthened its capabilities in relation to its information technology infrastructure management and security. The Group has a formally agreed IT strategy which ensures that priority is given to those areas which are most critical to the delivery of the Group's strategy and business plan. The Group maintains an ongoing programme of investment in IT infrastructure and systems. This includes investment in security solutions to counteract cyber security threats and specialist resource. A formal Cyber Incident Response Plan has been developed and reviewed ensure the Group is well placed to deal with any issues or events. The Group continues to be certified to ISO 27001 (Information Security Management) and ISO 22301 (Business Continuity).

Change	Whilst the Group continues to maintain a robust and secure IT infrastructure that supports its operational needs, the level and sophistication of cyber-crime continues to increase, heightening the risk of an impact on its business model and strategic objectives.	

Regulatory Risk

Description	Mitigation
Given the highly-regulated sectors in which the Group operates, compliance failures or failures to respond effectively to new and emerging regulatory and legal developments could result in reputational damage and financial loss.	The Group has Risk and Compliance and Legal teams who review key regulatory and legal developments to assess the impact on the Group's operations. These teams then work with business areas to provide advice on the implementation of appropriate measures to meet identified requirements. Expert external advice is also sought where necessary. Major regulatory or legal change initiatives are subject to formal change governance with progress reporting to the Risk and Compliance Committee. All employees are required to undertake regulatory training and testing to ensure appropriate levels of competence are maintained. Those in relevant specialist roles are also required to adhere to formal regulatory training and competence regimes. The Compliance function has developed a formal monitoring plan which is reviewed by the ORCC and the Risk and Compliance Committee to ensure that regulatory requirements have been satisfactorily embedded.

Change	Whilst the Group considers that it continues to have robust arrangements in place, the increasingly regulated nature of its operations heightens the potential risk arising from any failure to comply effectively with regulations.	

PRINCIPAL RISKS AND MITIGATION (Continued)

Liquidity and Capital Risk

Funding Risk

Description	Mitigation
The Group relies on access to various sources of funding to finance its operations. If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines. The Group now relies heavily on retail deposits for funding and therefore changes in market conditions could impact the ability of the business to maintain the level of liquidity required to sustain normal business activity.	The Group maintains a diversified range of both retail and wholesale medium and long term funding sources to cover future business requirements and liquidity to cover shorter term funding needs. The Group remains well funded with sufficient liquidity to meet all its financial obligations as they fall due. The Group, through Paragon Bank, is authorised to accept retail deposits. As such, it is subject to regulation by the PRA, which aims to ensure that sufficient liquid assets are held, at all times, to mitigate the liquidity risk inherent in deposit taking. The Bank has also been able to make drawings under the Bank of England's TFS to support its ongoing lending activities. Internally, comprehensive treasury policies are in place to ensure sufficient liquid assets are maintained and that all financial obligations can be met as they fall due.

Change	Following its recent corporate reorganisation, the Group is now better placed to access funding from a wide range of sources to meet its future funding requirements. Strong competition for retail deposits amongst challenger banks during the year means the overall risk is considered to have remained stable.	

Capital Risk

Description	Mitigation
The major part of the Group's lending portfolio is secured on residential property. Proposals made by the BCBS regarding potential changes from 2021 to the minimum capital requirements for lending secured on such assets could have a material impact on the Group.	In order to further enhance its existing robust credit management capabilities and to mitigate the risks of the proposed BCBS changes, the Group took a strategic decision in 2016 to seek the necessary regulatory approval to implement an IRB approach for credit risk. A formal IRB project has been initiated with support from respected external specialist advisors to enable the Group to submit an application to the relevant regulatory authorities as soon as possible. In June 2017, the PRA published an updated approach to IRB applications. The process is now modular, with each element covering a different aspect of a firm's plan for IRB implementation. This new application process is now embedded in the Group's IRB project plan.

Change	Whilst the Group has made good progress in relation to its IRB project, further clarity on the BCBS proposals is still awaited, particularly those relating to new capital floors. As a result, this risk is considered to have remained stable during the year. Further information on the Group's management of capital risk is given in note 4 to the accounts.	

PRINCIPAL RISKS AND MITIGATION (Continued)

Market Risk

Interest rate risk

Description	Mitigation
The Group is exposed to the risk that changes in interest rates may adversely affect its net income and profitability. In particular, the Group's profitability is determined by the difference between the interest rates at which it lends and those at which it borrows. Changes in market interest rates could therefore materially impact the Group's profits as a result of significant mismatches between its assets and liabilities.	This risk is managed through Board approved risk appetite limits with comprehensive Treasury Polices in place to ensure that the risk posed by changes and mismatches in interest rates are effectively managed. The Board's risk management framework for Interest Rate Risk in the Banking Book ('IRRBB') has been enhanced over the last year to reflect the updated BCBS principles and methods expected to be used by banks for controlling such risks. Day-to-day management of interest rate risk is the responsibility of Treasury with control and oversight provided by ALCO. The Group seeks to match the structure of assets and liabilities by using appropriate financial instruments, such as interest rate swaps or cap agreements and fixed rate retail liabilities.

Change	The Group's interest risk exposure profile, relative to its balance sheet has remained broadly similar and therefore associated risk levels remain generally stable compared to previous periods. Further information regarding the Group's management of interest rate risk is given in note 4 to the accounts.	

Pension Obligation Risk

Pension Obligation Risk

Description	Mitigation
The Group operates both a defined benefit and defined contribution pension scheme in the UK. There is a risk that the Group's commitments under its defined benefit scheme expose it to the risk that the assets of the scheme may be insufficient to meet its liabilities.	The Group's defined benefit scheme ('the Plan') was closed to new members with effect from February 2002. To mitigate the risks inherent in its exposure to the Plan, the Group conducts regular asset-liability reviews in conjunction with the Trustee. These reviews are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan and help in managing the volatility in the underlying investment performance. The Plan is subject to triennial formal valuation by the Plan actuary. The most recent valuation, as at 31 March 2016, was agreed by the Trustee during the year and a recovery plan was put in place which aims to clear the deficit of the Plan by January 2023.

Change	During the last year, changes in bond yields, equity prices, interest rates, mortality assumptions and inflation rates have all impacted favourably. The triennial valuation and recovery plan have also helped to reduce the risk in the Plan. Further details of the Group's exposure to the Plan are given in note 28 to the accounts.	

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 Finance PLC, a company registered in England and Wales with registration no: 01917566, for the year ended 30 September 2017.

DIRECTORS

The directors who served during the year and subsequently were:

N S Terrington

J A Heron

R D Shelton

R J Woodman

K G Allen

P E Rowland

M S Hayes

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 4 to the accounts.
- Information concerning the employment of disabled persons and the involvement of employees in the business is given in the strategic report.
- 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

23 January 2018

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.

P Sharp

Pandora Sharp

Company Secretary

23 January 2018

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF PARAGON FINANCE PLC

Opinion

We have audited the Financial Statements of Paragon Finance PLC for the year ended 30 September 2017 which comprise the profit and loss account, the statement of comprehensive income, the balance sheet, the statement of movements in equity and the related notes 1 to 30, including the accounting policies in note 2.

In our opinion the Financial Statements:

- give a true and fair view of the state of the company's affairs as at 30 September 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including Financial Reporting Standard 101 – 'Reduced Disclosure Framework'; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

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

Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

Strategic report and directors' report

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

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

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

Matters on which we are required to report by exception

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

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

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 17, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF PARAGON FINANCE PLC (CONTINUED)

Auditor's responsibilities

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

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

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

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

Simon Clark (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

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

23 January 2018

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2017

	Note	2017 £000	2016 £000
Interest receivable and similar income	5	29,328	33,907
Interest payable and similar charges	6	(26,526)	(30,197)
Net interest income		2,802	3,710
Other operating income	7	102,726	103,604
Total operating income		105,529	107,314
Operating expenses		(82,668)	(74,986)
Provisions for losses	10	(3,191)	577
		19,669	32,905
Fair value net loss	11	(1)	(1)
Operating profit, being profit on ordinary activities before taxation	12	19,668	32,904
Tax on profit on ordinary activities	13	(4,194)	(7,209)
Profit on ordinary activities after taxation	25	15,474	25,695

All activities derive from continuing operations.

STATEMENT OF COMPREHENSIVE INCOME

YEAR ENDED 30 SEPTEMBER 2017

	Note	2017 £000	2016 £000
Profit for the year		15,474	25,695
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss			
Actuarial profit / (loss) on pension fund	27	28,984	(37,152)
Deferred tax on actuarial profit / (loss)	14	(5,509)	6,846
Other comprehensive income for the year net of tax		23,475	(30,306)
Total comprehensive income for the year		38,949	(4,611)

BALANCE SHEET

30 SEPTEMBER 2017

	Note	2017 £000	2017 £000	2016 £000	2016 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Intangible assets	15	2,000		2,108	
Tangible assets	16	2,114		1,842	
Financial assets	17	-		5	
Investments – group companies	21	199,875		224,871	
			203,989		228,826
CURRENT ASSETS					
Debtors falling due within one year	22	77,187		289,581	
Cash at bank		46		-	
			77,233		289,581
			281,222		518,407
FINANCED BY					
EQUITY SHAREHOLDERS' FUNDS					
Called up share capital	24	76,164		53,447	
Profit and loss account	25	142,383		102,657	
			218,547		156,104
CREDITORS					
Amounts falling due within one year	26		32,817		303,859
RETIREMENT BENEFIT OBLIGATIONS	27		29,858		58,444
			281,222		518,407

These Financial Statements were approved by the Board of Directors on 23 January 2018.

Signed on behalf of the Board of Directors

R J Woodman

Director

STATEMENT OF MOVEMENTS IN EQUITY

YEAR ENDED 30 SEPTEMBER 2017

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	15,474	15,474
Other comprehensive income	-	23,475	23,475
Total comprehensive income for the year	-	38,949	38,949
Transactions with owners			
Issue of shares	22,717	-	22,717
Tax on share based remuneration (note 14)	-	777	777
Total Transactions with owners	22,717	777	23,494
Net movement in equity in the year	22,717	39,726	62,443
Opening equity	53,447	102,657	156,104
Closing equity	76,164	142,383	218,547

YEAR ENDED 30 SEPTEMBER 2016

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	25,695	25,695
Other comprehensive income	-	(30,306)	(30,306)
Total comprehensive income for the year	-	(4,611)	(4,611)
Transactions with owners			
Tax on share based remuneration (note 14)	-	(210)	(210)
Net movement in equity in the year	-	(4,821)	(4,821)
Opening equity	53,447	107,478	160,925
Closing equity	53,447	102,657	156,104

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

1. GENERAL INFORMATION

Paragon Finance 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 01917566. 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. ACCOUNTING POLICIES

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' the Company has applied the measurement and recognition requirements of International Financial Reporting Standards 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.

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 a going concern basis. The directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

Consolidated accounts

The Company is exempt under Section 400 of the Companies Act 2006 from the obligation to prepare group financial statements, being a wholly-owned subsidiary undertaking of Paragon Banking Group PLC.

Operating leases

Rental costs under operating leases are charged to the profit and loss account on a straight line basis over the period of the leases.

Intangible assets

Intangible assets comprise purchased computer software and other intangible assets acquired in business combinations.

Purchased computer software is capitalised where it has a sufficiently enduring nature and is stated at cost less accumulated amortisation. Amortisation is provided in equal instalments at a rate of 25% per annum.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

2. ACCOUNTING POLICIES (CONTINUED)

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and provision for impairment.

Depreciation

Depreciation is provided on cost or valuation in equal annual instalments over the lives of the assets. The rates of depreciation are as follows:

Short leasehold premises	over the life of the lease
Plant and machinery	25% per annum
Computer equipment	25% per annum
Furniture, fixtures and office equipment	15% per annum

Loans to customers

Loans to customers are considered to be 'loans and receivables' as defined by 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 4).

Impairment of loans and receivables

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.

Investments

The investment in the subsidiary companies is shown at cost less provision for impairment.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

2. ACCOUNTING POLICIES (CONTINUED)

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.

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 EIR basis.

Derivative financial instruments

Derivative instruments utilised by the Company comprise interest rate swaps. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Company in line with the Company's risk management policies (note 4).

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

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.

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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

2. ACCOUNTING POLICIES (CONTINUED)

Retirement benefit obligations

The expected cost of providing pensions within the funded defined benefit scheme, determined on the basis of annual valuations by professionally qualified actuaries using the projected unit method, is charged to the profit and loss. Actuarial gains and losses are recognised in full in the period in which they occur and do not form part of the result for the period, being recognised in the Statement of Comprehensive Income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets at the balance sheet date.

The expected financing cost of the deficit, as estimated at the beginning of the period is recognised in the result for the period within interest payable. Any variances against the estimated amount in the year form part of the actuarial gain or loss.

The charge to the profit and loss account for providing pensions under defined contribution pension schemes is equal to the contributions payable to such schemes for the year.

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.

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.

Share based payments

In accordance with IFRS 2 – 'Share based payments' ('IFRS 2'), the fair value at the date of grant of awards to be made in respect of options and shares granted under the terms of the Group's various share based employee incentive arrangements is charged to the profit and loss account over the period between the date of grant and the vesting date.

National Insurance on share based payments is accrued over the vesting period, based on the share price at the balance sheet date.

Where the allowable cost of share based awards for tax purposes is greater than the cost determined in accordance with IFRS 2, the tax effect of the excess is taken to reserves.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

2. ACCOUNTING POLICIES (CONTINUED)

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 3 'Business Combinations' in respect of business combinations undertaken by the Company.
- 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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

3. 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. The key assumptions revolve around estimates of future cash flows from customer's accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property. 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 the current 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.

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. 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.

Retirement benefits

The present value of the retirement benefit obligation is derived from an actuarial calculation which rests on a number of assumptions. These are listed in note 27. Where actual conditions differ from those assumed the ultimate value of the obligation would be different.

4. FINANCIAL RISK MANAGEMENT

The Company's operations were financed principally by a mixture of share capital and loans from other group companies. 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 subordinated loans to other group companies and its loans to customers. Subordinated loans made to other group companies provide the credit enhancement for the company to commence trading. The repayment of these loans is dependent on the credit performance of the loan assets in the creditor company and hence the credit risk on these balances is managed through careful management of the credit risk on the groups loans to customers.

The loans to customers in the Company and the Group are secured by first charges over residential properties in the United Kingdom. Despite this security, in assessing credit risk an applicant's ability to repay the loan remains the overriding factor in the decision to lend by the originator.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (Continued)

The Company administers the mortgages and the collections process is the same as that utilised for all companies in the group.

The maximum credit risk at 30 September 2017 approximates to the carrying value of loans to customers (note 18) and subordinated loans (note 21). There are no significant concentrations of credit risk due to the large number of customers included in the portfolios of other group companies.

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 will deal with, establishes limits for each counterparty and monitors compliance with those limits.

Liquidity risk

It is the Company's policy to ensure that adequate resources are available at all times to provide for the day to day activities of the Company and to meet regulatory requirements. Management considers the year end position satisfactorily reflects the policies and objectives set out above.

The Company has no external borrowings and liquidity is provided as part of the Group's working capital arrangements. The securitisation process and the terms of the warehouse facility effectively limit liquidity risk from the funding of the Group's loan assets. It remains to ensure that sufficient funding is available to fund the Group's participation in the SPVs, provide capital support for new loans and working capital for the Group. This responsibility rests with the Asset and Liability Committee which sets the Group's liquidity policy and uses detailed cash flow projections to ensure that an adequate level of liquidity is available at all times.

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 or cap agreements.

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.

Currency risk

The Company has no material exposure to foreign currency risk.

Use of derivative financial instruments

The Company uses derivative financial instruments for risk management purposes. Such instruments 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 or borrowing 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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

4. 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 19.

5. INTEREST RECEIVABLE AND SIMILAR INCOME

	2017 £000	2016 £000
On loans to other group companies	23,864	27,732
On loans to related parties	4,348	4,950
On loan notes issued by related parties	1,110	1,222
On loan notes issued by other group companies	4	2
On deposits	2	1
	29,328	33,907

6. INTEREST PAYABLE AND SIMILAR CHARGES

	2017 £000	2016 £000
On bank loans and overdrafts	46	18
On loans from other group companies	24,996	29,105
On loans from related parties	125	291
	25,167	29,414
Return on pension scheme liabilities (note 27)	1,359	783
	26,526	30,197

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

7. OTHER OPERATING INCOME

	2017 £000	2016 £000
Loan account fee income	159	236
Insurance income	9	14
Administration fees	22,481	20,238
Deferred sale consideration	-	23,150
Costs recharged to other group companies	80,077	59,966
	102,726	103,604

Administration fees are in respect of income receivable from various special purpose vehicle companies within the group which own mortgage and loan assets administered by the Company. Further details are given in note 20.

8. DIRECTORS AND EMPLOYEES

a) Directors

Three of the directors during the period (2016: three) were also directors of the parent company, Paragon Banking Group PLC. Their remuneration from the Paragon Group is set out in the Directors' Remuneration Report of Paragon Banking Group PLC. No amounts in respect of their emoluments are included in the disclosures below.

	2017 £000	2016 £000
Directors' emoluments:		
Other emoluments	1,156	1,073
	1,156	1,073
Pension contributions paid in respect of directors	30	29
Emoluments of the highest paid director:		
Excluding pension contributions	370	342
Pension contributions	-	-
	370	342

None of the directors during the year (2016: four) (none of whom are directors of the parent company (2016: three)) are members of the Paragon Group defined benefit pension scheme. At 30 September 2017, the accrued benefit under the pension scheme of the highest paid director was £nil (2016: £73,040). The number of directors during the year to whom retirement benefits were accruing under money purchase schemes was three (2016: four). The number of the directors during the year in respect of whose service shares were received or receivable under the Group's long-term incentive schemes was seven (2016: seven) (three of whom are directors of the parent company (2016: three)). Four of these directors, including the highest paid director exercised awards during the year.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

8. DIRECTORS AND EMPLOYEES (CONTINUED)

b) Employees

The average number of persons (including directors) employed by the Company during the year was 1,309 (2016: 929). The costs incurred during the year in respect of these employees were:

	2017	2017	2016	2016
	£000	£000	£000	£000
Share based remuneration	3,845		4,050	
Other wages and salaries	35,451		33,081	
Total wages and salaries		39,296		37,131
National insurance on share based remuneration	985		(132)	
Other social security costs	3,235		2,914	
Total social security costs		4,220		2,782
Defined benefit pension cost	2,369		1,666	
Other pension costs	539		475	
Total pension costs		2,908		2,141
Total staff costs		46,424		42,054

Details of the pension schemes operated by the Company are given in note 27.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

9. SHARE BASED REMUNERATION

During the year the Group had various share based payment arrangements with employees. They are accounted for by the Group and the Company as shown below.

The effect of the share based payment arrangements on the Company's profit is shown in note 8.

A summary of the number of share awards outstanding under each scheme at 30 September 2017 and at 30 September 2016 is set out below.

		Number 2017	Number 2016
(a)	Sharesave Plan	2,474,465	2,842,378
(b)	Performance Share Plan	4,467,338	5,373,623
(c)	Company Share Option Plan	234,314	-
(d)	Deferred Bonus Plan	445,252	422,245
(e)	Matching Share Plan	-	9,969
(f)	Restricted Stock Units	28,959	-
		7,650,328	8,648,215

(a) Share option schemes

The Group operates an All Employee Share Option ('Sharesave') scheme. Grants under this scheme vest, in the normal course, after the completion of the appropriate service period and subject to a savings requirement.

A reconciliation of movements in the number and weighted average exercise price of options over £1 ordinary shares during the year ended 30 September 2017 and the year ended 30 September 2016 is shown below.

	2017 Number	2017 Weighted average exercise price p	2016 Number	2016 Weighted average exercise price p
Options outstanding £1 ordinary shares				
At 1 October 2016	2,842,378	255.33	2,172,357	305.19
Granted in the year	524,741	341.76	2,001,234	249.44
In respect of employees transferring in	5,562	258.88	5,860	307.13
In respect of employees transferring out	(153,949)	249.21	(14,197)	291.59
Exercised in the year	(566,454)	247.16	(40,427)	107.48
Lapsed during the year	(177,813)	265.03	(1,282,449)	334.87
At 30 September 2017	2,474,465	275.56	2,842,378	255.33
Options exercisable	-	-	-	-

The weighted average remaining contractual life of options outstanding at 30 September 2017 was 28.6 months (2016: 30.22 months). The weighted average market price at exercise for share options exercised in the year was 414.02p (2016: 334.01p).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

9. SHARE BASED REMUNERATION (CONTINUED)

(a) Share option schemes (continued)

Options are outstanding under the Sharesave plans to purchase ordinary shares in the parent company are as follows:

Grant date	Period exercisable	Exercise price	Number 2017	Number 2016
Sharesave Schemes				
20/12/2011	01/02/2017 to 01/08/2017	142.56p	-	138,747
23/12/2013	01/02/2017 to 01/08/2017	276.32p	-	456,671
23/12/2013	01/02/2019 to 01/08/2019	276.32p	133,518	141,768
11/06/2015	01/08/2018 to 01/02/2019	345.68p	120,809	149,541
11/06/2015	01/08/2020 to 01/02/2021	345.68p	10,063	11,276
20/06/2016	01/08/2019 to 01/02/2020	249.44p	1,377,833	1,542,777
20/06/2016	01/08/2021 to 01/02/2022	249.44p	307,501	401,598
28/07/2017	01/09/2020 to 01/03/2021	341.76p	465,595	-
28/07/2017	01/09/2022 to 01/03/2023	341.76p	59,146	-
			2,474,465	2,842,378
			2,474,465	2,842,378

A number of the above options were granted to former employees whose rights terminate at the later of twelve months following redundancy or forty-two months after the issue of the options.

The fair value of options granted is determined using a Binomial model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2017 and the year ended 30 September 2016, which were all made under the Sharesave scheme, are shown below.

Grant date	**28/07/17**	**28/07/17**	**20/06/16**	**20/06/16**
Number of awards granted	465,595	59,146	1,592,420	408,814
Market price at date of grant	428.50p	428.50p	297.10p	297.10p
Contractual life (years)	3.5	5.5	3.5	5.5
Fair value per share at date of grant (£)	0.88	0.81	0.50	0.52
Inputs to valuation model				
Expected volatility	28.49%	27.47%	26.62%	29.47%
Expected life at grant date (years)	3.46	5.44	3.46	5.45
Risk-free interest rate	0.67%	0.88%	0.84%	0.98%
Expected dividend yield	3.24%	3.24%	3.94%	3.94%
Expected annual departures	5.00%	5.00%	5.00%	5.00%

The expected volatility of the share price used in determining the fair value is based on the annualised standard deviation of daily changes in price over the six years preceding the grant date. The five-year schemes use share price data for the preceding five years.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

9. SHARE BASED REMUNERATION (CONTINUED)

(b) Paragon Performance Share Plan ('PSP')

Awards under this plan comprise a right to acquire ordinary shares in the parent company for nil or nominal payment and will vest on the third anniversary of their granting, to the extent that the applicable performance criteria have been satisfied, if the holder is still employed by the Group. The awards will lapse to the extent that the performance condition has not been satisfied on the third anniversary.

Awards are exercisable from the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied to the day before the tenth anniversary of the grant date. Clawback provisions apply to awards granted under the PSP as detailed in the remuneration policy.

The conditional entitlements outstanding under this scheme at 30 September 2017 and 30 September 2016 were:

Grant date	Period exercisable	Number 2016	Number 2016
09/01/2007	09/01/2010 to 08/01/2017 †	-	569
14/06/2007	14/06/2010 to 13/06/2017 †	-	743
26/11/2007	26/11/2010 to 25/11/2017 †	-	3,287
21/05/2009	21/05/2012 to 20/05/2019 †	15,000	400,714
04/01/2010	04/01/2013 to 03/01/2020 †	79,334	79,334
17/12/2010	17/12/2013 to 16/12/2020 †	290,964	292,338
21/12/2011	21/12/2014 to 20/12/2021 †	313,162	624,259
28/02/2013	28/02/2016 to 27/02/2023 ‡	289,138	756,638
10/12/2013	10/12/2016 to 09/12/2023 ‡	310,130	1,133,944
18/12/2014	18/12/2017 to 17/12/2024 ‡	925,169	936,171
22/12/2015	22/12/2018 to 21/12/2025 §	1,132,620	1,145,626
01/12/2016	01/12/2019 to 30/11/2026 β	1,111821	-
		4,467,338	5,373,623

† These awards, which were conditional on the achievement of performance based criteria, have now vested.

‡ 50% of these awards are subject to a Total Shareholder Return ('TSR') test and 50% are subject to an Earnings Per Share ('EPS') test. The TSR test compares the rank of the parent company's TSR against a comparator group of companies comprising the constituents of the FTSE-250. 25% of the TSR tested awards vest for median performance, increasing on a straight line basis to full vesting for upper quartile performance.

The EPS test provides that 25% of EPS tested awards will vest where EPS growth of the Group is equal to the increase in the retail price index plus 3%, increasing on a straight line basis to full vesting for EPS growth equal to the increase in the retail price index plus 7% or more. In each case the testing period is the three financial years commencing with the year of grant.

§ 50% of these awards are subject to a TSR test and 50% are subject to an EPS test as described above, except that full vesting of the EPS tested awards takes place where EPS growth is equal to the increase in the retail price index plus 13% or more.

β 50% of these awards are subject to a TSR test and 25% are subject to an EPS test as described at ‡ above, except that the comparator group for the TSR test is limited to 13 listed financial service entities rather than the entire FTSE-250. 25% of these awards are subject to risk performance conditions which take in to account factors deemed appropriate by the Remuneration Committee, who will ultimately decide the extent to which the risk condition has been satisfied.

Once the outcomes of these tests have been determined the gross number of awards vesting will be reduced so that the gain to the recipient from the PSP and the CSOP described below is equal to the gain from the gross PSP vesting.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

9. SHARE BASED REMUNERATION (CONTINUED)

(b) Paragon Performance Share Plan ('PSP') (continued)

The fair value of awards granted under the Performance Share Plan is determined using a Monte Carlo simulation model, to take account of the effect of the market based condition. Details of the awards over £1 ordinary shares made in the year ended 30 September 2017 and the year ended 30 September 2016 are shown below:

Grant date	**01/12/16**	**22/12/15**
Number of awards granted	1,113,251	1,198,765
Market price at date of grant	369.40p	362.70p
Fair value per share at date of grant	245.73p	204.46p
Inputs to valuation model		
Expected volatility	29.55%	24.99%
Risk-free interest rate	0.76%	1.21%
Expected dividend yield	3.65%	3.03%

For all of the above grants the contractual life and expected life at grant date is three years and no departures are expected.

The expected volatility for awards granted between 18 July 2008 and 30 September 2008 is based on the annualised standard deviation of daily changes in price over the six years preceding the grant date. The expected volatility for awards granted after this date is calculated using the same method but using daily changes in price over the three years preceding the grant date.

The effect of the CSOPs is not allowed for in the IFRS 2 market values of the 2016 grant.

(c) Company Share Option Plan ('CSOP')

The Company has, in the current year, started to utilise the tax-advantaged element of the PSP under which CSOP options can be granted. The CSOPs may be exercised alongside their accompanying PSPs based upon the exercise price that was set at the grant date. Each member of staff may be granted up to a maximum total value of £30,000 of tax benefitted options.

A reconciliation of movements in the number and weighted average exercise price of CSOP options over £1 ordinary shares during the year ended 30 September 2017 and the year ended 30 September 2016 is shown below.

	2017 Number	2017 Weighted average exercise price p	2016 Number	2016 Weighted average exercise price p
Options outstanding				
At 1 October 2016	-	-	-	-
Granted in the year	235,385	361.88	-	-
Exercised or surrendered in the year	-	-	-	-
Lapsed during the year	(1,071)	361.88	-	-
At 30 September 2017	234,314	361.88	-	-
Options exercisable	-	-	-	-

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

9. SHARE BASED REMUNERATION (CONTINUED)

(c) Company Share Option Plan ('CSOP') (continued)

The conditional entitlements outstanding under this scheme at 30 September 2017 and 30 September 2016 were:

Grant date	Period exercisable	Exercise Price	Number 2017	Number 2016
01/12/2016	01/12/2019 to 30/11/2026 β	361.88p	234,314	-
			234,314	-

β 66.7% of these awards are subject to a TSR test and 33.3% are subject to an EPS test. These tests operate in the same manner and with the same conditions as those for the PSP grant of the same date.

To the extent that the CSOP awards vest, the vesting of the PSP award granted at the same time will be abated so that the overall gain to the grantee is the same as would be received on the related PSP award had the CSOP not been in place.

No separate fair value has been attributed to the CSOP options for IFRS 2 purposes as the IFRS 2 market values for the CSOP and PSP combined will equate to that calculated for the PSP without allowing for the CSOP. The benefit from the CSOP is in relation to the employees' tax position, which does not affect the IFRS 2 charge.

(d) Deferred Bonus awards

Awards under these plans comprise a right to acquire ordinary shares in the Company for nil or nominal payment. The conditional entitlements outstanding under these plans at 30 September 2017 and 30 September 2016 were:

Grant date	Period exercisable	Number 2017	Number 2016
10/12/2013	10/12/2016 to 09/12/2023	92,208	174,519
18/12/2014	18/12/2017 to 17/12/2024	113,202	113,202
22/12/2015	22/12/2018 to 21/12/2025	134,524	134,524
01/12/2016	01/12/2018 to 30/11/2026	105,318	-
		445,252	422,245

The Deferred Bonus shares awarded during 2013 and thereafter can be exercised from the third anniversary of the award date until the day before the tenth anniversary of the date of grant.

The Deferred Bonus shares granted in December 2016 do not accrue dividends over the vesting period unlike earlier grants. The fair value of Deferred Bonus awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2017 and the year ended 30 September 2016 are shown below.

Grant date	**01/12/16**	**22/12/15**
Number of awards granted	105,318	134,524
Market price at date of grant	369.4p	362.7p
Fair value per share at date of grant	331.1p	362.7p
Inputs to valuation model		
Risk-free interest rate	0.75%	1.21%
Expected dividend yield	3.65%	n/a

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

9. SHARE BASED REMUNERATION (CONTINUED)

(e) Matching Share Plan

Awards under this plan comprised a right to acquire ordinary shares in the Company for nil or nominal payment and vested on the third anniversary of their granting to the extent that the applicable performance criteria had been satisfied, if the holder was still employed by the Group.

The entitlements outstanding under this scheme at 30 September 2017 and at 30 September 2016 were:

Grant Date	Transfer date	Number 2017	Number 2016
02/01/2008	02/01/2011 to 02/01/2018	-	9,969
		-	9,969

The plan lapsed in February 2016 and was not renewed. Therefore, no further awards will be made under it.

(f) Restricted Stock Units ('RSUs')

The Company, in the current year, has permitted certain employees to elect to receive RSU awards instead of PSP awards. RSU awards have vesting conditions based upon the grantee's personal performance (including a risk element) rather than conditions in the wider business. These conditions are determined to be met to the extent to which the Remuneration Committee deems that to be the case.

The conditional entitlements outstanding under this scheme at 30 September 2017 and 30 September 2016 were:

Grant date	Period exercisable	Number 2017	Number 2016
01/12/2016	01/12/2019 to 30/11/2026	28,959	-
		28,959	-

The fair value of RSU awards issued in the year was determined using a Black-Scholes Merton model. Details of the awards over £1 ordinary shares made in the year ended 30 September 2017 and the year ended 30 September 2016 are shown below.

Grant date	**01/12/16**
Number of awards granted	28,959
Market price at date of grant	369.4p
Fair value per share at date of grant	369.4p
Inputs to valuation model	
Risk-free interest rate	0.75%
Expected dividend yield	3.65%

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

10. PROVISIONS FOR LOSSES

	2017 £000	2016 £000
Impairment of financial assets / (release of provision)		
First mortgage loans	89	(7)
Investments in group companies (note 21)	(2,120)	(1,538)
Loans to group companies	6,332	425
Loans to related parties	(1,110)	543
	3,191	(577)

11. FAIR VALUE NET LOSS

The fair value net loss of £1,000 (2016: £1,000) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The loss is primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities.

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

	2017 £000	2016 £000
Operating profit is after charging:		
Amortisation of intangible assets (note 15)	1,026	914
Depreciation on operating assets (note 16)	776	871
Auditor remuneration - audit services	52	51
Loss on disposal of fixed assets	-	24
Hire of plant and machinery	527	453
Hire of motor vehicles	289	341
Property rents	1,352	1,537

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 2017

13. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge for the year

	2017 £000	2016 £000
Current tax:		
Corporation tax	4,918	7,390
Adjustment in respect of prior periods	(839)	149
Total current tax	4,079	7,539
Deferred tax (note 23):		
Origination and reversal of timing differences	70	(368)
Recognition of previously unrecognised tax losses	49	(138)
Rate change	(4)	176
Total deferred tax	115	(330)
	4,194	7,209

b) Factors affecting the tax charge for the year

	2017 £000	2016 £000
Profit before tax	19,668	32,904
UK corporation tax at 19.5% (2016: 20%) based on the profit for the year	3,835	6,581
Effects of:		
Tax exempt revenues	752	(288)
Accelerated capital allowances	92	110
Tax on share based remuneration	309	619
Prior year (credit) / charge	(790)	11
Change in rate of taxation on deferred tax balances	(4)	176
	4,194	7,209

During the year ended 30 September 2015 the Government announced provisions further reducing the rate of corporation tax to 19.0% with effect from 1 April 2017 and to 18.0% from 1 April 2020 which were substantially enacted during the year. The tax rate applying from 1 April 2020 was further reduced to 17% during the year.

Therefore, the standard rate of corporation tax applicable to the Company for the year ended 30 September 2017 is expected to be 19.5%, the rate in the years ending 30 September 2018 and 30 September 2019 are expected to be 19.0%, the rate in the year ending 30 September 2020 is expected to be 18.0% and the rate in subsequent years is expected to be 17.0%. The expected impact on deferred tax balances of the changes to 19.0% and 17.0% was accounted for in the year ended 30 September 2016.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

14. TAX CREDITED TO EQUITY

	2016 £000	2015 £000
On actuarial profit / (loss) on pension scheme (note 27)	(5,509)	6,846
Tax on items recognised in comprehensive income	(5,509)	6,846
On share based payment (note 25)	777	(210)
Total tax (charged) / credited to equity	(4,732)	6,636
Of which		
Current tax	796	246
Deferred tax (note 23)	(5,528)	6,390
	(4,732)	6,636

15. INTANGIBLE ASSETS

	Computer software £000	Total £000
Cost		
At 1 October 2015	5,574	5,574
Additions	1,361	1,361
Disposals	-	-
At 30 September 2016	6,935	6,935
Additions	918	918
Disposals	-	-
At 30 September 2017	7,853	7,853
Accumulated amortisation		
At 1 October 2015	3,913	3,913
Charge for the year	914	914
On disposals	-	-
At 30 September 2016	4,827	4,827
Charge for the year	1,026	1,026
On disposals	-	-
At 30 September 2017	5,853	5,853
Net book value		
At 30 September 2017	2,000	2,000
At 30 September 2016	2,108	2,108

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

16. TANGIBLE FIXED ASSETS

	Short leasehold premises £000	Plant and machinery £000	Total £000
Cost			
At 1 October 2015	2,408	6,458	8,866
Additions	200	280	480
Disposals	(394)	(440)	(834)
At 30 September 2016	2,214	6,298	8,512
Additions	34	1,014	1,048
Disposals	-	(130)	(130)
At 30 September 2017	2,248	7,182	9,430
Accumulated depreciation			
At 1 October 2015	1,538	5,054	6,592
Charge for the year	258	613	871
On disposals	(393)	(400)	(793)
At 30 September 2016	1,403	5,267	6,670
Charge for the year	264	512	776
On disposals	-	(130)	(130)
At 30 September 2017	1,667	5,649	7,316
Net book value			
At 30 September 2017	581	1,533	2,114
At 30 September 2016	811	1,031	1,842

17. FINANCIAL ASSETS

	2017 £000	2016 £000
Loans to customers (note 18)	-	-
Derivative financial assets (note 19)	-	5
	-	5

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

18. LOANS TO CUSTOMERS

Loans to customers at 30 September 2017 and 30 September 2016, which are all denominated and payable in sterling, are first mortgages which are secured on residential property within the United Kingdom and which are categorised as loans and receivables as defined by IAS 39.

These balances relate to originations which took place in 1992 or earlier, and the Company does not currently originate loans on its own account.

Mortgage loans have a contractual term of up to thirty years, the borrower is entitled to settle the loan at any point and in most cases such early settlement does take place. All borrowers are required to make monthly payments, except where an initial deferred period is included in the contractual terms.

	2017 £000	2016 £000
Balance at 1 October 2015	-	-
Other movements	3	26
Repayments and redemptions	(3)	(26)
Balance at 30 September 2016	-	-

Other movements include primarily interest charged to customers on loans outstanding, impairment movements on these loans and other changes in the amortised cost of the assets caused by the effective interest rate method.

19. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

All of the Company's financial derivatives are held for economic hedging purposes, although not all may be designated for hedge accounting in accordance with the provisions of IAS 39. The analysis of the derivatives is shown below.

	2017 Notional amount £000	2017 Assets £000	2017 Liabilities £000	2016 Notional amount £000	2016 Assets £000	2016 Liabilities £000
Other derivatives						
Interest rate swaps	-	-	-	1,124	5	-
Total recognised derivative assets	-	-	-	1,124	5	-

20. SECURITISATIONS

As part of the Group's financing arrangements, Group companies have sold portfolios of mortgages or other loans to a number of other group companies referred to as 'special purpose vehicles' or SPVs.

The SPVs have issued securities which are secured on the assets acquired, to finance the purchase of those assets. In each case the Company has provided a subordinated loan to the issuer and met certain of its front end expenses which will be recovered over time. In certain cases the Company has also taken a minority shareholding or subscribed for loan stock.

The Company has entered into agreements with the SPVs under which it administers and manages the assets purchased by those companies. Other than its responsibilities with regard to these arrangements and the warranties given in the mortgage sale agreements, the Company has no commitment to repurchase the assets acquired by the SPVs or invest further in the SPVs and has no other liability in respect thereof.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

21. INVESTMENTS - GROUP COMPANIES

	2017 £000	2016 £000
Valuation		
At 1 October 2016	224,871	212,035
Investment during the year	22,125	19,352
Provisions movement (note 10)	2,120	1,538
Repayment of loans	(49,241)	(8,054)
At 30 September 2017	199,875	224,871

The investments are loans to the Group companies which are not subsidiaries of the Company. The investments include subordinated loans amounting to £144,363,000 (2016: £180,813,000) and investments in Asset Class Notes amounting to £55,512,000 (2016: £44,058,000).

The Company itself is a wholly-owned subsidiary and, therefore, no consolidated accounts have been prepared.

The directors consider that the value of the investments in subsidiary companies is at least equal to the amounts at which they are stated.

22. DEBTORS

	2017 £000	2016 £000
Amounts falling due within one year:		
Amounts due from group companies	43,617	253,839
Corporation tax	11,888	4,126
Deferred tax (note 23)	8,816	14,459
Other debtors	9,039	13,045
Prepayments and accrued income	3,827	4,112
	77,187	289,581

Included in the amount due from group companies is £43,524,000 (2016: £251,583,000) which is interest bearing.

23. DEFERRED TAX

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

	2017 £000	2016 £000
Balance at 1 October 2016	14,459	7,739
(Charge) / credit to reserves (note 14)	(5,528)	6,390
Profit and loss (charge) / credit (note 13)	(70)	368
Prior year profit and loss (charge) / credit (note 13)	(49)	138
Rate change (note 13)	4	(176)
Balance at 30 September 2017	8,816	14,459

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

23. DEFERRED TAX (CONTINUED)

The net deferred tax asset recognised is analysed as follows:

	2017 £000	2016 £000
Accelerated tax depreciation	377	348
Retirement benefit obligations	5,673	11,104
Impairment and other provisions	2,766	3,007
Net deferred tax asset	8,816	14,459

24. CALLED UP SHARE CAPITAL

	2017 £000	2016 £000
Allotted:		
71,262,521 ordinary shares of 75p each	53,447	53,447
30,289,734 ordinary shares of 75p each issued	22,717	-
	76,164	53,447

During the year 30,289,734 Ordinary shares of 75p each were subscribed for at par by the parent company (2016: nil).

25. PROFIT AND LOSS ACCOUNT

	£000
At 1 October 2015	107,478
Profit for the financial year	25,695
Actuarial loss on pension fund net of tax (note 27)	(30,306)
Tax on share based remuneration (note 14)	(210)
At 30 September 2016	102,657
Profit for the financial year	15,474
Actuarial profit on pension fund net of tax (note 27)	23,475
Tax on share based remuneration (note 14)	777
At 30 September 2017	142,383

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

26. CREDITORS

	2017 £000	2016 £000
Amounts falling due within one year:		
Bank loan and overdrafts	-	468
Amounts due to parent undertaking	-	122,922
Amounts due to group companies	16,666	158,914
Other creditors	2,792	7,352
Conduct	-	1,939
Accruals and deferred income	13,359	12,264
	32,817	303,859

The amounts due to parent undertaking is interest bearing and included in the amount due to group companies is £16,662,000 (2016: £144,093,000) which is interest bearing.

27. RETIREMENT BENEFIT OBLIGATIONS

(a) Defined benefit plan - Description

The Group operates a funded defined benefit pension scheme in the UK (the 'Plan'). The Plan assets are held in a separate fund, administered by a corporate trustee, to meet long-term pension liabilities to past and present employees. The Trustee of the Plan is required by law to act in the best interests of the Plan's beneficiaries and is responsible for the investment policy adopted in respect of the Plan's assets. The appointment of directors to the Trustee is determined by the Plan's trust documentation. The Group has a policy that one third of all directors of the Trustee should be nominated by active and pensioner members of the Plan.

Employees who are members of the Plan are entitled to receive a pension of 1/60 of their final basic annual salary for every year of eligible service (to a maximum of 2/3). Dependants of members of the Plan are eligible for a dependant's pension and the payment of a lump sum in the event of death in service.

The principal actuarial risks to which the Plan is exposed are:

- **Investment risk** – The risk that income is generated on the Plan's investments at a rate lower than the rate at which the defined benefit liability is calculated, which would cause an increased deficit in the Plan. The Trustee keeps the allocation of the Plan's investments under review to manage this risk on a long term basis.
- **Interest risk** – A decrease in bond yields will reduce the discount rate used in valuing the deficit and hence increase the Plan liability.
- **Inflation risk** – A rise in inflation will increase the benefits payable to Plan members, which would increase the Plan liability.
- **Longevity risk** – The value of the Plan deficit is calculated by reference to the best estimate of the mortality rate among Plan members both during and after employment. An increase in the life expectancy of the members would increase the deficit in the Plan.
- **Salary risk** – The valuation of the Plan assumes a level of future salary increases based on a premium over the expected rate of inflation. Should the salaries of Plan members increase at a higher rate then the deficit will be higher.

The risks relating to death in service payments are insured with an external insurance company.

As a result of the Plan having been closed to new entrants since February 2002, the service cost as a percentage of pensionable salaries is expected to increase as the average age of active members rises over time. However the membership is expected to reduce so that the service cost in monetary terms will gradually reduce.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The most recent full actuarial valuation of the Plan's liabilities, obtained by the Trustee, was carried out at 31 March 2016, by Aon Hewitt, the Plan's independent actuary. This showed that the value of the Plan's liabilities on a buy-out basis in accordance with section 224 of the Pensions Act 2004 was £214.0m, with a shortfall against the assets of £118.4m.

Following the 2016 actuarial valuation, the Trustee put in place a revised recovery plan. The Trustee's recovery plan aims to meet the statutory funding objective within six years and ten months from the date of valuation, that is by 31 January 2023.

(b) Defined benefit plan – Financial impact

For accounting purposes the valuation at 31 March 2016 was updated to 30 September 2017 in accordance with the requirements of IAS 19 (revised) by Mercer, the Group's independent consulting actuary.

The major categories of assets in the Plan at 30 September 2017 and 30 September 2016 and their fair values were:

	2017 £000	2016 £000
Cash	859	9,673
Equity instruments	58,721	55,959
Debt instruments	28,901	29,521
Real estate	9,808	8,927
Total fair value of Plan assets	98,289	104,080
Present value of Plan liabilities	(128,147)	(162,524)
(Deficit) in the Plan	(29,858)	(58,444)

At 30 September 2017 the Plan assets were invested in a diversified portfolio that consisted primarily of equity and debt investments. The majority of the equities held by the Plan are in developed markets. All investments of the Plan have quoted market prices in an active market, and are thus considered to be Level 1 financial instruments as defined by IFRS 13.

The movement in the fair value of the Plan assets during the year was as follows:

	2017 £000	2016 £000
At 1 October 2016	104,080	91,080
Interest on Plan assets	2,313	3,585
Cash flows		
Contributions by the Group	3,720	3,171
Contributions by Plan members	238	245
Benefits paid	(19,017)	(1,276)
Administration expenses paid	(390)	(459)
Remeasurement gain		
Return on Plan assets (excluding amounts included in interest)	7,345	7,734
At 30 September 2017	98,289	104,080

The actual return on scheme assets in the year ended 30 September 2017 was £9,658,000 (2016: £11,319,000).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

Benefits paid includes amounts transferred on the settlement of the Plan's commitments to certain members with large accrued benefits. No gain or loss arose on these transfers which will reduce the Plan's exposure to future volatility.

The movement in the present value of the Plan liabilities during the year was as follows:

	2017 £000	2016 £000
At 1 October 2016	162,524	112,635
Current service cost	2,369	1,666
Funding cost	3,672	4,368
Cash flows		
Contributions by scheme members	238	245
Benefits paid	(19,017)	(1,276)
Remeasurement (gain) / loss		
Arising from demographic assumptions	(6,713)	-
Arising from financial assumptions	(10,673)	44,886
Arising from experience adjustments	(4,253)	-
At 30 September 2017	128,147	162,524

The liabilities of the Plan are measured by discounting the best estimate of future cash flows to be paid out by the Plan using the Projected Unit method. This amount is reflected in the liability in the balance sheet. The Projected Unit method is an accrued benefits valuation method in which the Plan liabilities are calculated based on service up until the valuation date allowing for future salary growth until the date of retirement, withdrawal or death, as appropriate. The future service rate is then calculated as the contribution rate required to fund the service accruing over the next year again allowing for future salary growth. The major weighted average assumptions used by the actuary were (in nominal terms):

	2017	2016
In determining net pension cost for the year		
Discount rate	2.40%	3.90%
Rate of compensation increase	3.50%	3.55%
Rate of price inflation	3.00%	3.05%
Rate of increase of pensions	2.95%	3.00%
In determining benefit obligations		
Discount rate	2.70%	2.40%
Rate of compensation increase	3.60%	3.50%
Rate of price inflation	3.10%	3.00%
Rate of increase of pensions	2.90%	2.95%
Further life expectancy at age 60		
Male member aged 60	29	29
Female member aged 60	30	31
Male member aged 40	30	32
Female member aged 40	32	34

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The amounts charged in the profit and loss account in respect of the Plan are:

	Note	2017 £000	2016 £000
Current service cost		2,369	1,666
Administration expenses		390	459
Included within operating expenses		2,759	2,125
Funding cost of scheme liability		3,672	4,368
Interest on Plan assets		(2,313)	(3,585)
Net interest expense	6	1,359	783
Components of defined benefit costs recognised in profit and loss		4,118	2,908

The amounts recognised in the statement of comprehensive income in respect of the Plan are:

	2017 £000	2016 £000
Return on Plan assets (excluding amounts included in interest)	7,345	7,734
Actuarial gains / (losses)		
Arising from demographic assumptions	6,713	-
Arising from financial assumptions	10,673	(44,886)
Arising from experience adjustments	4,253	-
Total actuarial gain / (loss)	28,984	(37,152)
Tax (charge) / credit thereon (note 15)	(5,509)	6,846
Net actuarial gain / (loss)	23,475	(30,306)

(c) Defined benefit plan – Future cash flows

The sensitivity of the valuation of the defined benefit obligation to the principal assumptions disclosed above at 30 September 2017, calculating the obligation on the same basis as used in determining the IAS 19 value, is as follows:

Assumption	Increase in assumption	Impact on scheme liabilities
Discount rate	0.1% p.a.	2.3% decrease
Rate of inflation *	0.1% p.a.	2.3% increase
Rate of salary growth	0.1% p.a.	0.4% increase
Rates of mortality	1 year of life expectancy	2.8% increase

* maintaining a 0.5% real increase in salary growth

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The sensitivity analysis presented above may not be representative of an actual future change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation as some of the assumptions will be correlated. There has been no change in the method of preparing the analysis from that adopted in previous years.

In conjunction with the Trustee, the Group has continued to conduct asset-liability reviews of the Plan. These studies are used to assist the Trustee and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the studies are used to assist the Trustee in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the investment strategy of the Plan. There have been no changes in the processes by which the Plan manages its risks from previous periods.

The target asset allocations for the year ending 30 September 2017 are 60% growth assets (primarily equities), 30% bonds and 10% real estate.

The rate of employee contributions to the Plan is 5.0% of pensionable salaries. Before 1 April 2017 the agreed rate of employer contributions was 27.0% of gross salaries for participating employees with an additional contribution of £1.5m per annum for deficit reduction and £0.4m per annum to cover administration and life cover costs, payable monthly. After 1 April 2017, following the finalisation of the March 2016 valuation, employer contributions rose to 32.0% of gross salaries and the additional contribution for deficit reduction increased to £2.5m per annum. The £0.4m per annum contribution in respect of costs remained in place.

The present best estimate of the contributions to be made to the Plan by the Group in the year ending 30 September 2018 is £4.4m.

The average duration of the benefit obligations in the Plan at the year end are shown in the table below:

	2017 Years	2016 Years
Category of member		
Active members	24	26
Deferred pensioners	23	26
Current pensioners	16	16
All members	22	24

(d) Defined contribution arrangements

The Company sponsors a defined contribution (Stakeholder) pension scheme, open to all employees who are not members of the Plan. The Company successfully completed the auto-enrolment process mandated by the UK Government in November 2013, using this scheme.

The assets of these schemes are not Company assets and are held separately from those of the Company, under the control of independent trustees. Contributions made by the Company to these schemes in the year ended 30 September 2017, which represent the total cost charged against income, were £0.5m (2016: £0.5m) (note 8).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

28. FINANCIAL COMMITMENTS

At 30 September 2017 and 30 September 2016, the Company had outstanding commitments for future minimum lease payments under non-cancellable leases, which fall due as follows:

	2017 £000	2016 £000
Plant and machinery		
Within one year	583	338
Between two and five years	780	131
	1,363	469
Land and buildings		
Within one year	1,292	1,292
Between two and five years	4,513	2,050
Over five years	3,432	-
	9,237	3,342
	10,600	3,811

Operating lease payments represent rents payable by the Company in respect of certain of its office premises and lease payments on company vehicles and equipment. The average term of the current building leases from inception or acquisition is 5 years (2016: 5 years) with rents subject to review every five years, while the average term of the vehicle leases and office equipment is 3 years (2016: 3 years).

29. RELATED PARTY TRANSACTIONS

On 27 May 2010, Mr A K Fletcher, an independent non-executive director of the Group, was appointed as a trustee of the Group Pension Plan, and during the first quarter of 2013 became a director of its Corporate Trustee when that was put in place. In respect of this appointment he was paid £10,000 (2016: £10,000) in the year ended 30 September 2017 by the Company, the sponsoring company of the Plan.

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

Transactions with Arianty Holdings Limited ('AH')

At the balance sheet date the Company was owed £nil (2016: £154,000) by AH, a company under common control as defined by IAS 24, in relation to payments made on behalf of AH, which is included in other debtors.

Transactions with Arianty Services Limited ('AS')

At the balance sheet the Company was owed £nil (2016: £23,000) by AS, a company under common control as defined by IAS 24, in relation to payments made on behalf of AS, which is included in other debtors.

Transactions with First Flexible No.5 PLC ('FF5')

At the balance sheet date the Company was owed £114,000 (2016: £113,000) by FF5, a company under common control as defined by IAS 24, in relation to payments made on behalf of FF5, which is included in other debtors.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

29. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with Paragon Mortgages (No. 18) PLC ('PM18')

At the balance sheet date the Company acted as servicer of the mortgages for PM18, a company under common control as defined by IAS 24, and earned £36,000 (2016: £nil) during the year in servicing fees. At the balance sheet date PM18 owed £nil (2016: £nil) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company owed £nil (2016: £3,014,000) to PM18 in relation to payments made by PM18 on its behalf, which is included in other creditors.

The Company had held the subordinated loan for PM18 of £8,190,000, until it was repaid during the year, which was included in investments. During the year the Company earned £74,000 (2016: £375,000) in subordinated loan interest. At the balance sheet date PM18 owed £nil (2016: £16,000) in relation to subordinated loan interest, which are included in prepayments and accrued income.

The Company was the Fee Letter provider to PM18 which was repaid over a four year period. At the balance sheet date the outstanding Fee Letter was £nil (2016: £57,000), which was included in other creditors. During the year the Company earned £2,000 (2016: £41,000) in Fee letter interest and at the balance sheet date PM18 owed £nil (2016: £1,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Mortgages (No. 19) PLC ('PM19')

At the balance sheet date the Company acted as servicer of the mortgages for PM19, a company under common control as defined by IAS 24, and earned £155,000 (2016: £nil) during the year in servicing fees. At the balance sheet date PM19 owed £nil (2016: £nil) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £nil (2016: £920,000) by PM19 in relation to payments made on behalf of PM19, which is included in other debtors.

The Company had held the subordinated loan for PM19 of £10,500,000 and Class D notes issued by PM19 of £7,000,000, both were repaid during the year, which was included in investments. During the year the Company earned £285,000 (2016: £480,000) in subordinated loan interest and £101,000 (2016: £176,000) in Class D note interest. At the balance sheet date PM19 owed £nil (2016: £59,000) in relation to subordinated loan interest and £nil (2016: £21,000) relating to Class D note interest, which are included in prepayments and accrued income.

The Company was the Fee Letter provider to PM19 which was repaid over a four year period. At the balance sheet date the outstanding Fee Letter was £nil (2016: £295,000), which is included in other creditors. During the year the Company earned £16,000 (2016: £66,000) in Fee letter interest and at the balance sheet date PM19 owed £nil (2016: £5,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Mortgages (No. 20) PLC ('PM20')

At the balance sheet date the Company acted as servicer of the mortgages for PM20, a company under common control as defined by IAS 24, and earned £450,000 (2016: £11,000) during the year in servicing fees. At the balance sheet date PM20 owed £59,000 (2016: £2,000) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company owed £258,000 to PM20, relating to monies paid to the servicer which is included in other creditors (2016: PM20 owed £430,000 by the Company in relation to payments made on behalf of PM20, which is included in other debtors).

The Company had held the subordinated loan for PM20 of £10,500,000 (2016: £10,500,000) and Class D notes issued by PM20 of £7,000,000 (2016: £7,000,000), which is included in investments. During the year the Company earned £457,000 (2016: £480,000) in subordinated loan interest and £119,000 (2016: £134,000) in Class D note interest. At the balance sheet date PM20 owed £58,000 (2016: £59,000) in relation to subordinated loan interest and £15,000 (2016: £16,000) relating to Class D note interest, which are included in prepayments and accrued income.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

29. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with Paragon Mortgages (No. 20) PLC ('PM20') (continued)

The Company is the Fee Letter provider to PM20 which is repaid over a four year period. At the balance sheet date the outstanding Fee Letter was £308,000 (2016: £644,000), which is included in other creditors. During the year the Company earned £45,000 (2016: £78,000) in Fee letter interest and at the balance sheet date PM20 owed £4,000 (2016: £8,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Mortgages (No. 21) PLC ('PM21')

At the balance sheet date the Company acted as servicer of the mortgages for PM21, a company under common control as defined by IAS 24, and earned £411,000 (2016: £nil) during the year in servicing fees. At the balance sheet date PM21 owed £23,000 (2016: £nil) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £429,000 (2016: £1,083,000) by PM21 in relation to payments made on behalf of PM21, which is included in other debtors.

At the balance sheet date the Company held the subordinated loan for PM21 of £6,250,000 (2016: £6,250,000) and Class D notes issued by PM21 of £6,300,000 (2016: £6,300,000), which is included in investments. During the year the Company earned £272,000 (2016: £287,000) in subordinated loan interest and £154,000 (2016: £169,000) in Class D note interest. At the balance sheet date PM21 owed £12,000 (2016: £12,000) in relation to subordinated loan interest and £7,000 (2016: £7,000) relating to Class D note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM21 which is repaid over a four year period. At the balance sheet date the outstanding Fee Letter was £300,000 (2016: £540,000), which is included in other creditors. During the year the Company earned £52,000 (2016: £84,000) in Fee letter interest and at the balance sheet date PM21 owed £2,000 (2016: £3,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Mortgages (No. 22) PLC ('PM22')

At the balance sheet date the Company acted as servicer of the mortgages for PM22, a company under common control as defined by IAS 24, and earned £672,000 (2016: £nil) during the year in servicing fees. At the balance sheet date PM22 owed £31,000 (2016: £nil) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £823,000 (2016: £1,540,000) by PM22 in relation to payments made on behalf of PM22, which is included in other debtors.

At the balance sheet date the Company held the subordinated loan for PM22 of £7,502,000 (2016: £7,502,000) and Class E notes issued by PM22 of £7,500,000 (2016: £7,500,000), which is included in investments. During the year the Company earned £326,000 (2016: £344,000) in subordinated loan interest and £176,000 (2016: £194,000) in Class E note interest. At the balance sheet date PM22 owed £14,000 (2016: £14,000) in relation to subordinated loan interest and £8,000 (2016: £8,000) relating to Class E note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM22 which is repaid over a four year period. At the balance sheet date the outstanding Fee Letter was £494,000 (2016: £776,000), which is included in other creditors. During the year the Company earned £74,000 (2016: £111,000) in Fee letter interest and at the balance sheet date PM22 owed £3,000 (2016: £4,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Mortgages (No. 23) PLC ('PM23')

At the balance sheet date the Company acted as servicer of the mortgages for PM23, a company under common control as defined by IAS 24, and earned £767,000 (2016: £nil) during the year in servicing fees. At the balance sheet date PM23 owed £143,000 (2016: £nil) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

29. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with Paragon Mortgages (No. 23) PLC ('PM23') (continued)

At the balance sheet date the Company was owed £1,624,000 (2016: £2,271,000) by PM23 in relation to payments made on behalf of PM23, which is included in other debtors.

At the balance sheet date the Company held the subordinated loan for PM23 of £7,501,000 (2016: £7,501,000) and Class E notes issued by PM23 of £7,505,000 (2016: £7,505,000), which is included in investments. During the year the Company earned £327,000 (2016: £352,000) in subordinated loan interest and £218,000 (2016: £235,000) in Class E note interest. At the balance sheet date PM23 owed £67,000 (2016: £73,000) in relation to subordinated loan interest and £44,000 (2016: £49,000) relating to Class E note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM23 which is repaid over a four year period. At the balance sheet date the outstanding Fee Letter was £600,000 (2016: £877,000), which is included in other creditors. During the year the Company earned £79,000 (2016: £118,000) in Fee letter interest and at the balance sheet date PM23 owed £14,000 (2016: £21,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Mortgages (No. 24) PLC ('PM24')

At the balance sheet date the Company acted as servicer of the mortgages for PM24, a company under common control as defined by IAS 24, and earned £973,000 (2016: £nil) during the year in servicing fees. At the balance sheet date PM24 owed £227,000 (2016: £nil) to the Company in relation to servicing fees, which is included in prepayments and accrued income.

At the balance sheet date the Company was owed £2,471,000 (2016: £3,179,000) by PM24 in relation to payments made on behalf of PM24, which is included in other debtors.

At the balance sheet date the Company held the subordinated loan for PM24 of £9,542,000 (2016: £9,606,000) and Class D notes issued by PM24 of £8,753,000 (2016: £8,753,000), which is included in investments. During the period the Company earned £392,000 (2016: £403,000) in subordinated loan interest and £342,000 (2016: £316,000) in Class D note interest. At the balance sheet date PM24 owed £82,000 (2016: £93,000) in relation to subordinated loan interest and £70,000 (2016: £76,000) relating to Class D note interest, which are included in prepayments and accrued income.

The Company is the Fee Letter provider to PM24 which is repaid over a four-year period. At the balance sheet date the outstanding Fee Letter was £793,000 (2016: £1,110,000), which is included in other creditors. During the year the Company earned £99,000 (2016: £119,000) in Fee letter interest and at the balance sheet date PM24 owed £18,000 (2016: £26,000) in relation to Fee Letter interest, which is included in prepayments and accrued income.

Transactions with Paragon Fifth Funding Limited ('P5F')

At the balance sheet date the Company acted as servicer of the mortgages for P5F, a company under common control as defined by IAS 24, and earned £360,000 (2016: £nil) during the year in servicing fees. At the balance sheet date P5F owed £49,000 (2016: £nil) to the Company in relation to servicing fees (2016: The Company was owed £220,000 by P5F in relation to payments made on behalf of P5F) which is included in other debtors.

Transactions with Paragon Sixth Funding Limited ('P6F')

At the balance sheet date the Company was owed £20,000 (2016: £17,000) by P6F, a company under common control as defined by IAS 24, in relation to payments made on behalf of P6F, which is included in other debtors.

Transactions with Paragon Seventh Funding Limited ('P7F')

At the balance sheet date the Company acted as servicer of the mortgages for P7F, a company under common control as defined by IAS 24, and earned £467,000 (2016: £nil) during the year in servicing fees. At the balance sheet date P7F owed £nil (2016: £nil) to the Company in relation to servicing fees.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2017

30. ULTIMATE PARENT COMPANY

The Company's immediate parent undertaking is Paragon Bank PLC. The Company's ultimate parent company and ultimate controlling party is Paragon Banking Group PLC. The smallest and largest group into which the Company is consolidated is that of Paragon Banking Group PLC formerly known as The Paragon Group of Companies PLC, registered in England and Wales.

Copies of the financial statements of the Company and Paragon Banking Group PLC may be obtained from the Company Secretary, 51 Homer Road, Solihull, West Midlands, B91 3QJ.