Company Registration No: 4513176

PARAGON MORTGAGES (NO. 9) PLC

Report and Financial Statements

Year ended 30 September 2006

DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the year ended 30 September 2006.

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

The Company is a wholly owned subsidiary of The Paragon Group of Companies PLC ('the Group') and was set up to provide finance for its mortgage loan assets, by issuing mortgage backed floating rate loan notes and using the proceeds to purchase mortgage loans from other Group companies.

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

As shown in the company's profit and loss account on page 6, the company's net interest income increased by 624% over the prior year. This was due to a short trading period in 2005, the company acquired mortgage loan assets in July 2005, as a consequence only traded for three months as compared with the full year this year. Profit after tax has improved from £140,000 to £2,411,000.

The balance sheet on page 7 of the financial statements shows that the company's financial position at the year end. Loans to customers has decreased by 9% due to customers redeeming their accounts during the year, as a result the asset backed loan notes have reduced by 11% during the year. Details of amounts owed from and to other group companies are shown in notes 15 and 18.

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

PRINCIPAL RISKS AND UNCERTAINTIES

The Company is a securitisation company and has been structured so as to avoid, in as far as is possible all forms of financial risk. An analysis of the Company's exposure to financial risks is set out in note 3.

Group risks are discussed in the group's Annual Report which does not form part of this Report.

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

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

DIRECTORS' REPORT (CONTINUED)

DIRECTORS
The directors throughout the year and subsequently were:

N Keen
R D Shelton
J G Gemmell
A Mehmet
J P J Fairrie

N Keen is a director of the ultimate parent company. Accordingly his interests in shares of Group companies are disclosed in that company's directors' report.

J P J Fairre had no interests in Group companies either during the year or subsequently (2005: none).

R D Shelton, J G Gemmell and A Mehmet are employees of The Paragon Group of Companies PLC, and had beneficial interests in the ordinary share capital of that company under share option schemes as follows:

Director	Options at 30 September 2005	Options granted in the year	Options exercised in the year	Options at 30 September 2006
R D Shelton	265,642	-	-	265,642
J G Gemmell	263,733	1,779	69,053	196,459
A Mehmet	80,281	1,779	39,264	42,796

At 30 September 2006 J G Gemmell beneficially held 23,250 (2005: 8,967) ordinary shares and R D Shelton held 57,777 (2005: 55,651) ordinary shares in that company.

Interest of directors in shares of the holding company under the Paragon Performance Share Plan:

Director	Share plan at 30 September 2005	Share plan awarded in the year	Share plan exercised in the year	Share plan at 30 September 2006
R D Shelton	43,467	9,585	10,526	42,526
J G Gemmell	45,168	9,585	17,763	36,990
A Mehmet	68,134	13,967	28,509	53,592

Interest of the directors in shares of the holding company under the Paragon Deferred Bonus Scheme:

Director	As at 30 September 2005	Granted during the year	Exercised during the year	As at 30 September 2006
R D Shelton	7,404	1,647	-	9,051
J G Gemmell	7,844	1,647	-	9,491

Under the Deferred Bonus Scheme the shares awarded will be transferred to J G Gemmell and R D Shelton as soon as is reasonably practical after 1 October 2006.

Interest of the directors in shares of the holding company under the Paragon Matching Share Plan:

Director	As at 30 September 2005	Granted during the year	Exercised during the year	As at 30 September 2006
R D Shelton	-	9,880	-	9,880
J G Gemmell	-	9,880	-	9,880

Awards are exercisable for six months from the date on which the Remuneration Committee determines the extent to which the performance conditions have been satisfied. EPS performance is measured over the three year period commencing 1 October 2005 and TSR over the three year period commencing 1 January 2006.

DIRECTORS' REPORT (CONTINUED)

No other director had any interest in the shares of the Company or of other Company companies either during or after the end of the year. None of the directors had any interest either during or at the end of the year in any material contract or arrangement with the company. None of the directors had a service contract with the company.

CREDITOR PAYMENT POLICY

The company agrees terms and conditions with its suppliers. Payment is then made on the terms agreed, subject to the appropriate terms and conditions being met by the supplier. The trade creditor days figure has not been stated as the measure is not appropriate to the business.

AUDITORS

The directors have taken all necessary steps to make themselves and the Company's auditors 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 auditors are unaware.

A resolution for the re-appointment of Deloitte & Touche LLP as the auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

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

J G Gemmell
Secretary,
26 January 2007

STATEMENT OF DIRECTORS' RESPONSIBILITIES

in relation to Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements. The directors have chosen to prepare accounts for the company in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP). Company law requires the directors to prepare such financial statements for each financial year which 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 and comply with UK GAAP and the Companies Act 1985. 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 accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a directors' report which comply with the requirements of the Companies Act 1985.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PARAGON MORTGAGES (NO. 9) PLC

We have audited the financial statements of Paragon Mortgages (No. 9) PLC for the year ended 30 September 2006 which comprise the profit and loss, the balance sheet, the statement of total recognised gains and losses, the statement in movement in shareholders' funds and the related notes 1 to 21. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors' 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.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 30 September 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Birmingham, United Kingdom
26 January 2007

PROFIT AND LOSS ACCOUNT

Year ended 30 September 2006

	Note	2006 £'000	2005 £'000
Interest receivable			
Mortgages		40,033	8,162
Other		1,321	243
		41,354	8,405
Interest payable and similar charges	4	(35,275)	(7,565)
Net interest income		6,079	840
Other operating income		297	59
Total operating income		6,376	899
Operating expenses		(2,995)	(684)
Provisions for losses	6	(89)	(15)
		3,292	200
Fair value net gains	7	152	-
Operating profit, being profit on ordinary activities before taxation	8	3,444	200
Tax on profit on ordinary activities	9	(1,033)	(60)
Profit on ordinary activities after taxation	17	2,411	140

All activities derive from continuing operations.

BALANCE SHEET
30 September 2006

	Note	2006 £'000	2006 £'000	2005 £'000	2005 £'000
ASSETS EMPLOYED					
FIXED ASSETS					
Financial Assets	11		623,399		682,699
CURRENT ASSETS					
Debtors falling due within one year	15	151		576	
Investments		18,040		31,000	
Cash at bank		8,803		6,531	
			26,994		38,107
			650,393		720,806
FINANCED BY					
SHAREHOLDERS' FUNDS					
Called up share capital	16	12		12	
Reserves	17	3,613		140	
			3,625		152
CREDITORS					
Amounts falling due within one year	18	10,910		12,141	
Amounts falling due after more than one year	18	635,858		708,513	
			646,768		720,654
			650,393		720,806

These financial statements were approved by the Board of Directors on 26 January 2007.

Signed on behalf of the Board of Directors

R D Shelton
Director

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

Year ended 30 September 2006

	Note	2006 £'000	2005 £'000
Profit attributable to members of the company		2,411	140
Cash flow hedge loss taken to equity		(2)	-
Tax on items taken directly to equity		-	-
Total recognised gains and losses for the year		2,409	140
Change in accounting policy on adoption of FRS 25 and FRS 26	17	1,564	
Total Gains and losses recognised since last Annual Report and Financial Statements		3,973	

STATEMENT OF MOVEMENT IN SHAREHOLDERS' FUNDS

	Note	2006 £'000	2005 £'000
Profit attributable to shareholders		2,411	140
Dividends		(500)	-
Cash flow hedge loss taken to equity		(2)	-
Net movement in shareholders' funds		1,909	140
Change in accounting policy on adoption of FRS 25 and FRS 26	17	1,564	-
Opening shareholders' funds		152	12
Closing shareholders' funds		3,625	152

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. **ACCOUNTING POLICIES**

The financial statements are prepared in accordance with applicable UK accounting standards. The particular accounting policies adopted are described below. They have been applied consistently throughout the current and preceding years with the exception of the policy in respect of loans to customers, impairment, borrowings and derivatives (see below).

Financial Reporting Standards 25 and 26 'Financial instruments: Disclosure and Presentation' and 'Financial Instruments: Recognition and Measurement' respectively, have been applied for the first time in the year and balances brought forward at 1 October 2005 have been adjusted accordingly, increasing the value of loans to customers by £2,330,000, recognising derivative financial instruments at a fair value liability of £4,341,000 and recognising a fair value adjustment from portfolio hedging of £1,150,000 resulting in an increase in profit and loss reserve by £1,633,000 and recogninising a cashflow hedge reserve of (£69,000).

As permitted by FRS 25 and 26, comparative amounts have not been restated and are presented in accordance with the accounting policies adopted in preparing the financial statements for the year ended 30 September 2005, and, in particular, those provisions of FRS 13 – 'Derivatives and other Financial Instruments: Disclosures' which are superseded by FRS 25 and 26.

The principal adjustments which would have been required to make the comparative amounts conform to the requirements of FRS 25 and 26 derive from the use of the Amortised Cost method to value the company's loans to its customers, the recognition of income on the Effective Interest Rate basis, the adoption of the impairment methodology required by FRS 26, the valuation of derivative financial instruments at fair value and the use of the hedging provisions of the new standard.

As the information needed to account for certain financial instruments in the comparative period was not available at the time, especially with regard to hedging, it is not practicable to quantify the impact of this change on the profit figure for the preceding year.

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.

Loans to Customers

In the results for the year ended 30 September 2006

Loans to customers are considered to be 'loans and receivables' as defined by Financial Reporting Standard 26 – 'Financial Instruments: Measurement' (FRS 26). They are therefore accounted for on the amortised cost basis.

Such loans are valued at inception at the initial advance amount, which is the fair value at that time, inclusive of procuration fees paid to brokers or other business providers and less initial fees paid by the customer. 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.

In the results for the year ended 30 September 2005

Interest arising on loans is recognised in the profit and loss account as it is charged to borrowers, to the extent that is expected to be recoverable. Other fee income arising from borrower accounts is recognised in 'other income' as it is charged.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. ACCOUNTING POLICIES (CONTINUED)

Impairment of Loans and Receivables

In the results for the year ended 30 September 2006

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date, in accordance with FRS 26. Where loans exhibit objective evidence of impairment, 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, discounted at the original EIR. Loans are assessed collectively, compared 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.

In the results for the year ended 30 September 2005

The amount provided is an estimate of the amount needed to reduce the carrying value of the asset to its expected recoverable amount and is based on the application of formulae which take into account the nature of each portfolio, borrower payment profile and expected losses.

Current assets - Investments

Balances shown as current asset investments in the balance sheet comprise short-term deposits with banks with maturities of more than 7 days and not more than 90 days.

Transactions with other Group companies

The company has taken advantage of the exemption granted by Financial Reporting Standard 8 - 'Related Party Disclosures' and does not therefore provide details of transactions with other Group companies as it is a wholly owned subsidiary of The Paragon Group of Companies PLC and its accounts are publicly available.

Corporation Tax

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

Deferred Taxation

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Borrowings

In the results for the year ended 30 September 2006

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

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

In the results for the year ended 30 September 2005

Borrowings are stated at their outstanding value less unamortised issue costs and discounts on issue.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. ACCOUNTING POLICIES (CONTINUED)

Derivative Financial instruments

In the results for the year ended 30 September 2006

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

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.

In the results for the year ended 30 September 2005

Derivative instruments utilised by the Company comprise currency swaps and interest rate swaps. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Company in line with the Company's risk management policies. Amounts payable or receivable in respect of interest rate swaps are recognised as adjustments to interest expense over the period of the contracts. The Company does not enter into speculative derivative contracts.

Hedging

In the results for the year ended 30 September 2006

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 arrangement put in place are considered to be 'highly effective' as defined by FRS 26.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of FRS 26, 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 FRS 26. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the profit and loss account at the same time as the hedged item affects the profit and loss account. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction is recognised, or is no longer highly probable.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. ACCOUNTING POLICIES (CONTINUED)

Fee and commission income

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

Foreign currency

Foreign currency transactions, assets and liabilities are accounted for in accordance with Financial Reporting Standard 23 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with cash flow hedging provisions of FRS 26.

Cashflow Statement

The Company has taken advantage of the exemption granted by Financial Reporting Standard 1 - 'Cashflow *Statements*' and does not therefore provide a cashflow statement as it is a wholly owned subsidiary of The Paragon Group of Companies PLC and its accounts are publicly available.

2. 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.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

2. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

Effective interest rates

In order to determine the effective interest rate applicable to loans an estimate must be made of the expected life of each loan and hence the cash flows relating thereto. These estimates are based on historical data and reviewed regularly. The accuracy of the effective interest rate applied would therefore be compromised by any differences between actual borrower behaviour and that predicted.

Fair values

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

3. FINANCIAL RISK MANAGEMENT

The Company's operations are financed principally by floating rate, asset backed loan notes and, to a lesser extent, by a mixture of share capital and loans from other group companies. The Company issues financial instruments to finance the acquisition of its portfolio of loans to customers and uses derivative financial instruments to hedge interest rate risk arising from fixed rate lending. In addition, various financial instruments, for example debtors, prepayments and accruals, arise directly from the Company's operations.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken.

The principal risks arising from the Company's financial instruments are credit risk, liquidity risk and interest rate risk. The board of the Company's holding company reviews and agrees policies for all companies in the Group managing each of these risks and they are summarised below. These policies have remained unchanged throughout the year and since the year end.

Credit risk

The Company's credit risk is primarily attributable to its loans to customers. The maximum credit risk at 30 September 2006 approximates to the carrying value of loans to customers (note 12). There are no significant concentrations of credit risk due to the large number of customers included in the portfolios.

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

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

Paragon Finance PLC and Mortgages Trust Services PLC continues to administer the mortgages on behalf of Paragon Mortgages (No. 9) PLC and the collections process is the same as that utilised for all companies in the group.

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

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk

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

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 rates payable on the asset backed loan notes issued by the Company are reset quarterly on the basis of LIBOR, EURIBOR, or USD. The interest rates charged on the Company's variable rate loan assets are determined by reference to, inter alia, the Company's funding costs and the rates being charged on similar products in the market. Generally this ensures the matching of changes in interest rates on the Company's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term.

In part, the Company's interest rate hedging objectives are achieved by the controlled mismatching of the dates on which instruments mature, redeem or have their interest rates reset. The table below summarises these repricing mismatches. For the purposes of the table, loan assets, borrowings and derivatives are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity dates. For those fixed rate loan assets where the customer has contracted to make regular repayments of both capital and interest, the assets have been allocated across the time bands in the table by reference to the contracted repayments. The analysis takes no account of early terminations which are likely to occur in practice. In determining the amount of hedging required, the Company makes assumptions about the level of regular capital repayments and early terminations of its loan assets. The actual interest rate sensitivity will therefore be determined by reference to subsequent customer and management decisions and is expected to be less sensitive than shown.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

	3 months or less	More than 3 months but not more than 6 months	More than 6 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Non interest bearing	Total
At 30 September 2006	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Finacial Assets	299,690	25,997	186,481	110,440	791	-	623,399
Debtors	-	-	-	-	-	151	151
Investments	18,040	-	-	-	-	-	18,040
Cash at bank and in hand	8,803	-	-	-	-	-	8,803
Total assets	326,533	25,997	186,481	110,440	791	151	650,393
Shareholders' funds	-	-	-	-	-	(3,625)	(3,625)
Asset backed loan notes	(616,666)	-	-	-	-	-	(616,666)
Derivative financial liability	(6,872)	-	-	-	-	-	(6,872)
Subordinated loan	(12,320)	-	-	-	-	-	(12,320)
Other liabilities	-	-	-	-	-	(10,910)	(10,910)
Total liabilities and shareholders' funds	(635,858)	-	-	-	-	(14,535)	(650,393)
Notional swap principal	300,980	(7,020)	(187,410)	(105,950)	(600)		
Interest rate repricing gap	(8,345)	18,977	(929)	4,490	191	(14,384)	-
Cumulative gap	(8,345)	10,632	9,703	14,193	14,384	-	-

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

At 30 September 2005	3 months or less £'000	More than 3 months but not more than 6 months £'000	More than 6 months but not more than 1 year £'000	More than 1 year but not more than 5 years £'000	More than 5 years £'000	Non interest bearing £'000	Total £'000
Loans to customers	369,839	21,683	28,026	256,251	6,900	-	682,699
Debtors	-	-	-	-	-	576	576
Investments	31,000	-	-	-	-	-	31,000
Cash at bank and in hand	6,531	-	-	-	-	-	6,531
Total assets	407,370	21,683	28,026	256,251	6,900	576	720,806
Shareholders' funds	-	-	-	-	-	(152)	(152)
Asset backed loan notes	(696,193)	-	-	-	-	-	(696,193)
Subordinated loan	(12,320)	-	-	-	-	-	(12,320)
Other liabilities	-	-	-	-	-	(12,141)	(12,141)
Total liabilities and shareholders' funds	(708,513)	-	-	-	-	(12,293)	(720,806)
Notional swap *principal*	282,180	-	(17,800)	(258,280)	(6,100)	-	-
Interest rate repricing gap	(18,963)	21,683	10,226	(2,029)	800	(11,717)	-
Cumulative gap	(18,963)	2,720	12,946	10,917	11,717	-	-

The Company monitors the interest rate risk exposure on its loan assets and asset backed loan notes and ensures compliance with the requirements of the trustees in respect of the notes.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Currency risk

All of the Group's assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in euros, which is described in note 20. Although FRS 26 requires that they be accounted for as currency liabilities and valued at their spot rates, it was a condition of the issue of these notes that the interest rate and currency swaps were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR linked floating rate sterling borrowing. As a result the Company has no material exposure to foreign currency risk.

The equivalent sterling principal amounts of notes in issue under these arrangements, and their carrying values at 30 September 2006 and 30 September 2005 are:

	2006 EQUIVALENT STERLING PRINCIPAL £'000	2006 CARRYING VALUE £'000	2005 EQUIVALENT STERLING PRINCIPAL £'000	2005 CARRYING VALUE £'000
US dollar notes	29,884	28,459	33,900	33,900
Euro notes	281,138	278,047	290,003	290,003

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 FRS 26 either because natural accounting offsets are expected, or obtaining hedge accounting would be especially onerous.

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

The Company has also designated cash flow hedging relationships, principally arising from currency borrowings, where a specified foreign exchange basis swap, set up as part of the terms of the borrowing is used.

Fair values of financial assets and financial liabilities

Fair values have been determined for all derivatives, listed securities and any other financial assets and liabilities for which an active and liquid market exists. The fair values of cash at bank and in hand, bank loans and overdrafts and asset backed loan notes are not materially different from their book values because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset on a quarterly basis.

Derivative financial instruments are stated at their fair values. The fair values of the interest rate swaps and caps have been determined by reference to prices available from the markets on which these instruments are traded.

The fair value of loans to customers is considered to be not materially different to the amortised cost value at which they are disclosed.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Set out below is a comparison by category of book values and fair values of the Company's derivative financial instruments as they were disclosed at 30 September 2005 under UK GAAP.

	2005 Book value £'000	2005 Fair value £'000
Derivative financial instruments held to manage the interest rate profile		
Swaps	-	(1,248)

4. INTEREST PAYABLE AND SIMILAR CHARGES

	2006 £'000	2005 £'000
Asset backed loan notes	33,537	6,874
Internal funding costs	268	65
Interest on fee letter	310	84
Interest rate swap	67	26
Subordinated loan interest	1,093	216
Amortised issue costs	-	300
	35,275	7,565

As permitted by FRS 26 the interest figures shown above for the years ended 30 September 2006 and 30 September 2005 are prepared under different bases (see note 1). They are therefore not directly comparable.

5. DIRECTORS AND EMPLOYEES

Directors' remuneration from the company during the year is stated in note 8.

Two directors exercised share options in the parent company during the year (2005: three directors).

The only employees during the year or the preceding year were the directors as disclosed on page 2.

6. PROVISIONS FOR LOSSES

	2006 £'000	2005 £'000
Impairment of financial assets		
First mortgage loans	89	15

7. FAIR VALUE NET GAINS

The fair value net gain of £152,000 (2005: £nil) 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 gain is primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

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

	2006 £'000	2005 £'000
Operating profit is after charging:		
Directors' fees	5	1
Auditors' remuneration - audit services	7	7

Non audit fees provided to the group are disclosed in the accounts of the parent company and the exemption to disclose non-audit services in these accounts has been taken.

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge for the year

	2006 £'000	2005 £'000
UK corporation tax at 30% (2005: 30%) based on the profit for the year		
Corporation tax	362	60
Deferred tax (note 19)	671	-
	1,033	60

b) Factors affecting the current tax charge

	£'000	£'000
Profit before tax	3,444	200
Tax at 30%	1,033	60
Movement on short term timing differences	(671)	-
	362	60

10. DIVIDEND

An interim dividend of £10.00 per share was paid during the year (2005:£nil). No final dividend is proposed (2005: £nil).

During the year ended 30 September 2006 the company declared and paid dividends amounting to £0.5 million. Although the company had sufficient distributable reserves to make each dividend payment, the relevant interim accounts had not been filed with the Registrar of Companies as required. Consequently payment of the dividends was a technical infringement of the Companies Act 1985.

On 29 September 2006 the directors appropriated distributable profits of the company to these payments of the dividends and released the relevant shareholders from any claims that the company may have had in relation to such payments.

These financial statements have been drawn up on the basis that the technical infringement described above has been regularised in the manner described.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

11. FINANCIAL ASSETS

	2006	2005
	£'000	£'000
Loans to customers (note 12)	622,932	682,699
Fair value adjustments from portfolio hedging	(1,098)	-
Derivative financial assets (note 14)	1,565	-
	623,399	682,699

12. LOANS TO CUSTOMERS

These comprise mortgage loans secured on residential properties in the United Kingdom and are categorised as loans and receivables as defined by FRS 26 (note 13).

	2006	2005
	£'000	£'000
Balance at 1 October 2005	682,699	-
Adoption of FRS 25 and 26 (note 1)	2,330	-
Additions	20,628	702,365
Other debits	40,827	10,265
Repayments and redemptions	(123,552)	(29,931)
Balance at 30 September 2006	622,932	682,699

Other debits includes primarily interest receivable on loans outstanding and discount effect of EIR. As permitted by FRS 26 the interest figures shown above for the years ended 30 September 2006 and 30 September 2005 are prepared under different bases (see note 1). They are therefore not directly comparable.

13. LOANS AND RECEIVABLES

Loans and receivables at 30 September 2006 and 30 September 2005, which are all denominated and payable in sterling, were first mortgages which are secured on residential property within the United Kingdom.

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 settlement does take place. All borrowers are required to make monthly payments, except where an initial deferred period is included in the contractual terms.

The average rate of interest being charged on customer accounts and the average rate at which income is being recognised under the effective interest rate method at 30 September 2006 was;

	Average rate charged to customers 2006	Average effective interest rate 2006
Mortgage loans	5.72%	6.14%

The interest rate repricing profile of the above loans is shown in note 3. All the mortgage loans are pledged as collateral for liabilities at 30 September 2006 and 30 September 2005.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

14. 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 on FRS 26. The analysis below therefore splits derivatives between those accounted for as hedges and those which, while representing an economic hedge do not qualify for this treatment.

	2006 Notional Amount £'000	2006 Assets £'000	2006 Liabilities £'000
Derivatives in accounting hedge relationships			
Fair value hedges			
Interest rate swaps	298,978	1,559	(175)
	298,978	1,559	(175)
Cash flow hedges			
Foreign exchange basis swaps	311,022	-	(6,671)
Interest rate swaps	1,000	6	-
	312,022	6	(6,671)
	611,000	1,665	(6,846)
Other derivatives			
Interest rate swaps	2,399	-	(26)
Total recognised derivative assets / (liabilities)	613,399	1,665	(6,872)

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

14. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

Under UK GAAP changes in the fair value of instruments used as hedges were not recognised in the financial statements until the hedged position matures. Set out below is an analysis of those unrecognised gains and losses at 30 September 2005 as required under UK GAAP.

	2005 Gains £'000	2005 Losses £'000	2005 Total net gains / (losses) £'000
Gains and losses arising in the year that were not recognised in the year	164	(1,412)	(1,248)
Unrecognised gains and losses on hedges at 30 September 2005	164	(1,412)	(1,248)
Of which:			
Gains and losses expected to be realised in the year to 30 September 2006	87	(664)	(577)
Gains and losses expected to be realised in the year to 30 September 2007 or later	77	(748)	(671)
	164	(1,412)	(1,248)

The values stated for 30 September 2005 have been amended by using the valuation model used for the 2006 statutory accounts having adopted FRS 25 and 26.

15. DEBTORS

	2006 £'000	2005 £'000
Amounts falling due within one year:		
Amount due from Group companies	109	500
Prepayments and accrued income	42	76
	151	576

The fair value of the above items are not considered to be materially different to their carrying values.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

16. CALLED UP SHARE CAPITAL

	2006 £	2005 £
Authorised:		
50,000 ordinary shares of £1 each	50,000	50,000
Allotted:		
49,998 ordinary shares of £1 each (25p called up and paid)	12,500	12,500
2 ordinary shares of £1 each (fully paid)	2	2
	12,502	12,502

17. COMBINED STATEMENT OF MOVEMENTS IN SHAREHOLDER'S FUNDS AND STATEMENT OF MOVEMENT ON RESERVES

	Profit and loss account £'000	Cash flow hedge reserve £'000	Total reserves £'000
At 1 October 2004	-	-	-
Profit for the financial year	140	-	140
At 30 September 2005	140	-	140
FRS 25 and 26 transition	2,330	(98)	2,232
Deferred tax on FRS 25 and 26 adjustments	(697)	29	(668)
Change of accounting policy on adoption of FRS 25 and 26	1,633	(69)	1,564
At 1 October 2005	1,773	(69)	1,704
Profit for the financial year	2,411	-	2,411
Movement in fair value of hedging derivatives	-	(2)	(2)
Dividends	(500)	-	(500)
At 30 September 2006	3,684	(71)	3,613

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

18. CREDITORS

	2006 £'000	2005 £'000
Amounts falling due within one year:		
Amounts due to Group companies	4,449	4,431
Corporation tax	423	60
Deferred tax (note 19)	1,340	-
Accruals and deferred income	4,698	7,650
	10,910	12,141

Included with the accruals and deferred income is an amount of £490,000 (2005: £725,000) due to fellow subsidiaries of The Paragon Group of Companies PLC.

	2006 £'000	2005 £'000
Amounts falling due after more than one year :		
Asset backed loan notes	616,666	696,193
Derivative financial liabilities (note 14)	6,872	-
Intercompany subordinated loan	12,320	12,320
	635,858	708,513

A maturity analysis and further details of the asset backed loan notes are given in note 20.

19. DEFERRED TAX

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

	2006 £'000	2005 £'000
Balance at 1 October 2005	-	-
Adoption of FRS 25 / 26 (note 1)	669	-
Profit and loss charge	671	-
Balance at 30 September 2006	1,340	-

The net deferred tax liability for which provision has been made is analysed as follows:		
Other timing differences	1,340	-

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

20. BORROWINGS

The Mortgage Backed Floating Rate Notes are secured over a portfolio comprising varaible rate mortgage loans secured by first charges over residential properties in the United Kingdom. The Notes are subject to mandatory redemption in part on each Interest payment Date in an amount equal to the principal received or recovered in respect of the mortgage. The maturity date of the notes matches the maturity date of the underlying assets. It is likely that a substantial proportion of these notes will be repaid within five years.

The Company has the option to repay all of the notes at an earlier date, at the outstanding principal amount.

Interest is payable at a fixed margin above:

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

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

Notes in issue at 30 September 2006 and 30 September 2005 were:

Notes	Maturity date	Call date	Principal Outstanding 2006	Principal Outstanding 2005	Note Margin Current	Note Margin Step up
			£m	£m		
'Aa'	May 2041	May 2009	305.0	346.0	0.18%	0.36%
'Ba'	May 2041	May 2009	7.0	7.0	0.29%	0.58%
'Ca'	May 2041	May 2009	3.0	3.0	0.52%	1.04%
			$m	$m		
'Ac'	May 2041	May 2009	52.9	60.0	0.18%	0.36%
			€m	€m		
'Ab'	May 2041	May 2009	312.9	355.0	0.18%	0.36%
'Bb'	May 2041	May 2009	29.5	29.5	0.29%	0.58%
'Cb'	May 2041	May 2009	66.0	66.0	0.52%	1.04%

There is a Subordinated Loan Facility under which an amount was drawn down by the company to establish the First Loss Fund, which is repayable to Mortgage Trust Services PLC and Paragon Loan Finance (No.2) PLC on the earlier of the last Interest Payment Date in May 2041 or the first day on which there are no Notes outstanding, except that on any Interest Payment Date sums borrowed will be repaid to the extent of any amount released from the First Loss Fund. Interest is payable at the rate of 4% above the London Interbank Offered Rate for three month sterling deposits.

There are no amounts of committed but undrawn facilities at 30 September 2006 and September 2005.

21. ULTIMATE PARENT COMPANY

The company's immediate and ultimate parent company and ultimate controlling party is The Paragon Group of Companies PLC, a company registered in England and Wales. Copies of the Company's financial statements are available from that company's registered office at St Catherine's Court, Herbert Road, Solihull, West Midlands, B91 3QE.