Company Registration No: 03901943

PARAGON DEVELOPMENT FINANCE LIMITED

Report and Financial Statements

Year ended 30 September 2019

STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

Paragon Development Finance Limited ('the Company') is a wholly owned subsidiary of Paragon Bank Plc, which itself is a wholly owned subsidiary of Paragon Banking Group PLC ('the Group') and was set up to provide finance for its development finance loan assets.

The Company was set up to originate development finance loans funded by borrowing from a fellow group company. This continues to be the principal activity of the Company. During the year the Company operated in the United Kingdom. The Company is currently engaged in loan relationships with other group companies. Paragon Bank PLC provided funding to the Company to purchase its original loan book and provides funding for further advances. The directors are not aware, at the date of this report, of any likely major changes in the Company's activities in the next year.

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

As shown in the Company's profit and loss account on page 7, the profit after tax for the year was £16,944,000 (2018: £3,043,000). This was due to an increase in interest receivable on development finance loans as loans to customers increased by 66%.

The balance sheet on page 8 of the Financial Statements shows the Company's financial position at the year end. Loans to customers was £424,603,000 (2018: £252,592,000); as a result, the balance owed to group companies as at 30 September 2019 was £374,595,000 (2018: £299,881,000).

The directors recommend no final dividend (2018: £nil) which, given the interim dividend of £nil per share (2018: £nil per share), means a total dividend for the year of £nil per share (2018: £nil per share).

The directors of the Company consider the results for the year to be satisfactory and are regularly monitoring the current market environment, including the impact of the Novel Coronavirus 19 ('Covid-19') pandemic, to assess likely changes in the level of performance in the coming year.

The Covid-19 pandemic does not impact on the results for the year ended 30 September 2019, as it had yet to have an impact on the markets or operations at that time. The potential impact on the business in the year ending 30 September 2020 cannot yet be quantified at the time of signing until the impact of the pandemic on customers and the level to which this is mitigated by government interventions becomes clearer.

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

PRINCIPAL RISKS AND UNCERTAINTIES

The assets of the Company are located entirely in the United Kingdom and its results are therefore impacted by the economic environment within the UK. A material downturn in economic performance could increase the numbers of customers who default on loans and / or cause the values of the properties over which the Company enjoys security to fall. The likelihood of this occurring has become more difficult to forecast given the continuing material uncertainties regarding the UK's withdrawal from the European Union.

Following the Company's year end the UK economy began to be impacted significantly by the effects of the Covid-19 virus in March 2020. This has caused major economic disruption within the UK and global economy but has also driven governments and regulators to offer unprecedented levels of support to businesses and consumers, aimed at mitigating its impact.

The Company has put contingency plans in place to ensure that it can continue to service its customers and to ensure that its liquidity and capital positions are protected through the crisis. However, should the pandemic have significant long-term impacts on the UK economy then this would significantly impact the Company's future performance.

STRATEGIC REPORT (CONTINUED)

PRINCIPAL RISKS AND UNCERTAINTIES (CONTUNUED)

An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out in note 7, a discussion of critical accounting judgements is set out in note 5 and a discussion of critical accounting estimates is set out in note 6. 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.

GOING CONCERN

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

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

Approved by the Board of Directors

and signed on behalf of the Board

K G Allen

Director

17 June 2020

DIRECTORS' REPORT

The directors present their Annual Report prepared in accordance with Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and the audited Financial Statements of Paragon Development Finance Limited, a company registered in England and Wales with registration no: 03901943, for the year ended 30 September 2019.

DIRECTORS

The directors throughout the year and subsequently were:

R J Doe (resigned 30 September 2019)

K G Allen

R D Shelton

R J Woodman

D Newcombe (appointed 21 October 2019)

J E Phillipou (appointed 21 October 2019)

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.

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

INFORMATION PRESENTED IN OTHER SECTIONS

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

- Commentary on the likely future developments in the business of the Company, including events taking place after the balance sheet date, is included in the Strategic Report.
- A description of the Company's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 7 to the accounts.
- Disclosure of 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
17 June 2020
Registered Office: 51 Homer Road, Solihull, West Midlands, B91 3QJ

STATEMENT OF DIRECTORS' RESPONSIBILITIES
in relation to Financial Statements

The directors are responsible for preparing the Strategic Report, the Directors' 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 they have elected to prepare the financial statements in accordance with UK accounting standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework.*

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company 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 judgements 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;
- assess the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

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

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

K G Allen

Director

17 June 2020

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF PARAGON DEVELOPMENT FINANCE LIMITED

Opinion

We have audited the Financial Statements of Paragon Development Finance Limited for the year ended 30 September 2019 which comprise the profit and loss account, the balance sheet, the statement of movements in equity and the related notes 1 to 22, including the accounting policies in note 4.

In our opinion the Financial Statements:

- give a true and fair view of the state of the company's affairs as at 30 September 2019 and of its 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

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

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 a year from the date of approval of the financial statements. In our evaluation of the directors' conclusions, we considered the inherent risks to the company's business model, including the impact of Brexit, and analysed how those risks might affect the company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the company will continue in operation.

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.

INDEPENDENT AUDITOR'S REPORT
TO THE MEMBERS OF PARAGO DEVELOPMENT FINANCE LIMITED (CONTINUED)

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

Auditor's responsibilities

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

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

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

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

Matthew Rowell (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

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

17 June 2020

PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2019

	Note	2019 £000	2018 £000
Interest receivable			
Development finance loans		35,159	6,259
Other		4	2
		35,163	6,261
Interest payable and similar charges	9	(9,274)	(1,810)
Net interest income		25,889	4,451
Other operating income		893	315
Total operating income		26,782	4,766
Operating expenses		(3,134)	(504)
Provisions for losses	15	(2,906)	(418)
Operating profit, being profit on ordinary activities before taxation	11	20,742	3,844
Tax on profit on ordinary activities	12	(3,798)	(801)
Profit on ordinary activities after taxation	20	16,944	3,043

All activities derive from continuing operations.

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

BALANCE SHEET

30 SEPTEMBER 2019

	Note	2019 £000	2019 £000	2018 £000	2018 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Tangible fixed assets	13	28		-	
Financial assets	14	401,595		67,171	
Investments – loans to group companies	16	50,426		50,685	
			452,049		117,856
CURRENT ASSETS					
Financial assets	14	23,008		185,421	
Debtors falling due within one year	17	78		376	
Cash at bank		4,684		487	
			27,770		186,284
			479,819		304,140
FINANCED BY					
EQUITY SHAREHOLDER'S FUNDS					
Called up share capital	19	80,000		-	
Profit and loss account	20	19,940		3,043	
			99,940		3,043
CREDITORS					
Amounts falling due within one year	21		379,879		301,097
			479,819		304,140

These Financial Statements were approved by the Board of Directors on 17 June 2020.

Signed on behalf of the Board of Directors

K G Allen

Director

STATEMENT OF MOVEMENTS IN EQUITY

YEAR ENDED 30 SEPTEMBER 2019

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	16,944	16,944
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	16,944	16,944
Transactions with owners			
Issue of shares	80,000	-	80,000
Net movement in equity in the year	80,000	16,944	96,944
Opening equity	-	3,043	3,043
Change in accounting policy on adoption of IFRS9	-	(47)	(47)
As restated	-	2,996	2,996
Closing equity	80,000	19,940	99,940

YEAR ENDED 30 SEPTEMBER 2018

	Share capital £000	Profit and loss account £000	Total equity £000
Total comprehensive income for the year			
Profit for the year	-	3,043	3,043
Other comprehensive income	-	-	-
Total comprehensive income for the year	-	3,043	3,043
Cancellation of shares	(100)	100	-
Net movement in equity in the year	(100)	3,143	3,043
Opening equity	100	(100)	-
Closing equity	-	3,043	3,043

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

1. GENERAL INFORMATION

Paragon Development Finance Limited ('the Company') is a company domiciled in the United Kingdom and incorporated in England and Wales under the Companies Act 2006 with company number 03901943. The address of the registered office is 51 Homer Road, Solihull, West Midlands, B91 3QJ. The nature of the Company's operations and its principal activities are set out in the Strategic Report.

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

2. BASIS OF PREPARATION

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

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

Adoption of new and reviewed reporting standards

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

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

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

Comparability of information

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

3. CHANGES IN ACCOUNTING STANDARDS

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

IFRS 9 – Overview

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

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

IFRS 9 – Classification

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

In accordance with the new rules:

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

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

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

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

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

	Post-transition £000	Pre-transition £000
Financial Assets		
Cash at bank	487	487
Loans to customers	252,535	252,592
	253,022	253,079
Financial Liabilities		
Amounts due to group companies	299,881	299,881
	299,881	299,881

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

IFRS 9 – Impairment

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

This introduces a number of new concepts and changes to the approach required by IAS 39. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. This has the effect of recognising losses on loans earlier than at present, as IAS 39 requires provisions to be made only at the point where a loss has actually occurred and there is objective evidence of credit impairment.

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

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

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

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date. These accounts would be largely unprovided for under IAS 39, although some cases with adverse qualitative indicators might have been addressed by a collective emergence provision. Such provisions under IAS 39 were designed to cover assets where a loss event had occurred before the reporting date, but this event had not yet affected performance

- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan. This is likely to lead to an increase in provision in general, though the IAS 39 emergence provision would have also addressed some of this risk

- For assets which were purchased or originated as credit impaired ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the required treatment is largely similar under IAS 39 and IFRS 9. This classification also includes credit impaired assets recognised in corporate acquisitions under IFRS 3. Purchased performing accounts are not classified as POCI, but are first recognised in Stage 1

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

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

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

The introduction of IFRS 9 resulted in an increase in the Company's impairment provision of £57,000 at the transition date, 1 October 2018. The impact is set out below:

	IAS 39 £000	IFRS 9 £000	Change £000	Change %
Loans to customers				
Mortgages	252,592	252,535	(57)	(0.02)%
Total	252,592	252,535	(57)	(0.02)%

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

	£000
Impairment on loans to customers	
At 30 September 2018 under IAS 39	8,987
IFRS 9 transition adjustments	57
Change in write-off definition	-
At 1 October 2018 under IFRS 9	9,044

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

The increase in impairment on transition will be allowed as a deduction for the purposes of UK Corporation Tax under the Change in Accounting Practices Regulations. This is spread over the ten years following transition for loan assets and is allowable in the 2019 tax computations. A deferred tax asset of £10,000 has been recognised on transition.

Cash balances, and the amounts due from group companies balance shown in note 16 are classified as financial assets accounted for at amortised cost and are therefore subject to the impairment provisions of IFRS 9. However, these assets are principally exposures to highly rated banks. The ECLs on these counterparties are considered to be minimal. The value, tenor and potential for default of the other exposures is such that any potential IFRS 9 provision is insignificant.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

3. CHANGES IN ACCOUNTING STANDARDS (CONTINUED)

IFRS 7 – Disclosure

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

This has, therefore, required significant amendments to the disclosures presented as note 15 (loans and impairment) in these accounts compared to those presented for the year ended 30 September 2018. When new notes address impairment, no comparative amounts are required to be disclosed, but for other new requirements, comparative amounts under the new standard at 30 September 2018 are shown.

Summary

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

		£000	£000
Equity at 30 September 2018			3,043
IFRS 9			
Impairment	(note 15)	(57)	
Deferred tax thereon	(note 18)	10	
		(47)	
Total adjustments			(47)
Equity at 1 October 2018			2,996

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

4. ACCOUNTING POLICIES

The particular accounting policies applied are described below.

Accounting convention

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

Going concern

As Paragon Bank PLC ('the Bank') is the ultimate principal creditor of the Company, the Company is dependent on the support of the Group so as to continue as a going concern.

The directors have made an assessment covering a period of at least 12 months from the date of approval of these financial statements which indicate that, taking account of reasonably possible downsides, the company will have sufficient funds, to meet its liabilities as they fall due for that period.

Those forecasts are dependent on the Bank not seeking repayment of the amounts currently due to the group, which at 30 September 2019 amounted to £374,595,000. The Bank has indicated that it does not intend to seek repayment of these amounts for the period covered by the forecasts. As with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Going concern (continued)

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed plans are produced for two year periods with longer term forecasts covering a five year period which include detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short-term and strategic basis.

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was recently reviewed in detail as part of the annual Internal Capital Adequacy Assessment Process ('ICAAP') cycle.

In compiling the most recent forecasts, particular attention was paid to the potential consequences of Covid-19 on the Group's operations, customers, funding and prospects, both in the short and longer term. This included consideration of a number of different scenarios with impacts of varying duration and severity. In common with the Group's approach to IFRS 9, the economics used in the forecasting process were updated in April, after the impact of Covid-19, based on updated external projections. Future business activity was reforecast reflecting the impacts of the pandemic on markets and products.

The forecast was based on the best available information at the time of its approval, but the uncertainties surrounding the potential impact of Covid-19 and the nature, duration and effectiveness of government measures to address it, mean that accurate forecasting is a more complex task than in normal circumstances. Therefore, further scenario modelling was undertaken to evaluate the impact of adverse stresses of the forecast variables with the greatest impact.

These stresses did not include management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern assessment. Under all of these scenarios, the Group was able to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity.

The Directors, therefore, consider that the Bank and Group have adequate resources to continue in operational existence for the next 12 months.

In addition to the above, the Directors consider that the company remains an integral part of the Group.

Taking this into account, the Directors, therefore, consider that the Company, with the support of its parent, has adequate resources to continue in operational existence for the next 12 months. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Loans to customers

Year ended 30 September 2019 under IFRS 9

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

Year ended 30 September 2019 under IFRS 9 (continued)

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

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

Where financial assets are credit-impaired at initial recognition the EIR is calculated on the basis of expected future cash receipts allowing for the effect of credit risk. In other cases, the expected contractual cash flows are used.

Year ended 30 September 2018 under IAS 39

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

Such loans are valued at inception as the amount of initial advance, which is the fair value at that time, inclusive of procuration fees paid to brokers or other business providers and less initial fees paid by the customer. Thereafter they are valued at this amount less the cumulative amortisation calculated using the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by a provision for balances which are considered to be impaired.

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Impairment of loans and receivables

Year ended 30 September 2019 under IFRS 9

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

With the exception of 'Purchased or Originated as Credit Impaired' ('POCI') financial assets (which are discussed separately below), all assets are assessed to determine whether there has been a significant increase in credit risk ('SICR') since the point of first recognition (origination or acquisition). Assets are also reviewed to identify any which are 'Credit Impaired'. SICR and credit impairment are identified on the basis of pre-determined metrics including qualitative and quantitative factors relevant to each portfolio, with a management review to ensure appropriate allocation.

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

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

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

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

For loan portfolios acquired at a discount, the discounts take account of future expected impairments and such assets are treated as POCI. For these assets, the Company recognises all changes in future cash flows arising from changes in credit quality since initial recognition as a loss allowance with any changes recognised in profit or loss.

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. ACCOUNTING POLICIES (CONTINUED)

Impairment of loans and receivables

Year ended 30 September 2018 under IAS 39

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

Loss events reflect both loans that display delinquency in contractual payments of principal or interest or, other objective evidence of delinquency available to the Company.

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.

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets, at rates calculated to write off the cost of each asset, on a straight line basis, over its expected useful life, as follows:

Fixtures, fittings and equipment	3 -5 years straight line
Computer equipment	3 years straight line

Current tax

The charge for taxation represents the expected UK corporation tax and other income taxes arising from the Company's profit for the year. This consists of the current tax which will be shown in tax returns for the year and tax deferred because of temporary differences. This in general, represents the tax impact of items recorded in the current year but which will impact tax returns for periods other than the one in which they are included in the financial statements.

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.

Revenue

The revenue of the Company comprises of interest receivable on loans to customers and other operating income. The accounting policy for the recognition of revenue is described separately within these accounting policies. Interest receivable on loans to customers is recognised in accordance with the effective interest rate method.

Fee and commission income

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

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

4. 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.

Borrowings

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

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

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
- The requirement to provide comparative period reconciliations in respect of fixed assets
- Disclosures in respect of transactions with wholly owned subsidiaries
- Disclosures in respect of capital management
- The effects of new, but not yet effective IFRSs
- Disclosures in respect of key management personnel
- Disclosures of transactions with a management entity which provides key management personnel services to the Company

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

- Certain disclosures required by IFRS 13 – 'Fair Value Measurement'

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

5. CRITICAL ACCOUNTING JUDGEMENTS

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

Significant Increase in Credit Risk ('SICR')

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

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

More information on the definition of SICR adopted is given in note 15.

Definition of default

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

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

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

More information on the Company's definition of default adopted is given in note 15.

Classification of financial assets

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

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

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

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

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

Therefore, the Company has classified its customer loan assets as carried at amortised cost.

6. CRITICAL ACCOUNTING ESTIMATES

Certain balances reported in the Financial Statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most significant of these are:

Impairment losses on loans to customers

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

Internal information used will include number of months arrears and qualitative information, such as information on corporate performance or intended or current enforcement activity.

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

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

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

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

In order to provide forward looking economic inputs to the modelling of the ECL, the Company must derive a set of scenarios which are internally coherent. The Company addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes.

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

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

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

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.

7. FINANCIAL RISK MANAGEMENT

The Company's operations are financed principally by loans from other group companies. The principal risks arising from the Company's financial instruments is credit 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. The Company's primary financial liabilities are with other group companies; therefore, the directors do not consider that the Company is exposed to any significant cash flow or liquidity risks.

Credit risk

The assets of the Company which are subject to credit risk are set out below:

	Note	2019 £000	2018 £000
Loans to customers	15	424,603	252,592
Cash		4,684	487
Investments	16	50,426	50,685
Maximum exposure to credit risk		479,713	303,764

Development finance loans are secured by the development property and various charges over the build.

Development finance loans do not require customers to make payments during the life of the loan, therefore arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. The average loan to gross development value ('LTGDV') ratio for the portfolio at year end, a measure of security cover, is analysed below.

	2019 By value	2019 By number	2018 By value	2018 By number
LTGDV	%	%	%	%
50% or less	9.94	3.45	0.85	2.08
50% to 60%	16.96	10.34	20.23	16.67
60% to 65%	25.06	31.72	61.26	50.00
65% to 70%	36.90	41.38	8.53	22.92
70% to 75%	8.03	11.03	0.00	0.00
Over 75%	3.11	2.08	9.13	8.33
	100.0	100.0	100.0	100.0

The average LTGDV cover at the year end was 66.16% (2018: 63.20%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports.

At 30 September 2019 the development finance portfolio comprised 145 accounts (2018: 44) with a total carrying value of £424,603,000 (2018: £252,592,000).

Currency risk

The Company has no material exposure to foreign currency risk.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

8. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using a fair value hierarchy reflecting the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices,
- Level 2 measurements are derived from observable data, such as market prices or rates,
- Level 3 measurements rely on significant inputs which are not derived from observable data.

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from 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.

The following table presents the fair values of financial instruments, including those not recognised in the financial statements at fair value.

	2019 Carrying Value £000	2019 Fair Value £000	2018 Carrying Value £000	2018 Fair Value £000
Financial assets				
Loans and advances to banks	4,684	4,684	487	487
Loans and advances to customers	424,603	424,603	252,592	252,592
Other assets	50,426	50,426	50,685	50,685
	479,713	479,713	303,764	303,764
Financial liabilities				
Other borrowed funds	374,595	374,595	299,881	299,881
Other liabilities	4,046	4,046	801	801
	378,641	378,641	300,682	300,682

The Company had no financial assets or liabilities in the year ended 30 September 2019 or the period ended 30 September 2018 valued using level 3 measurements.

The Company has not reclassified any of its measurements during the period.

The methods by which fair value is established for each class of financial assets and liabilities is set out below.

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the period end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. This also applies to the parent company's loans to its subsidiaries.

Loan assets

To assess the likely fair value of the Company's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Company's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 2 measurements. Market prices are not, however, available for certain financial assets and liabilities held or issued by the Company. Where no active market price or rate is available, fair values are estimated using present value or other valuation techniques, using inputs based on market conditions existing at the balance sheet date.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

9. INTEREST PAYABLE AND SIMILAR CHARGES

	2019 £000	2018 £000
Interest payable to other group companies	9,274	1,810

10. DIRECTORS AND EMPLOYEES

Directors received no remuneration for the services provided to the Company during either the current or the preceding year.

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

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

	2019 £000	2018 £000
Operating profit is after charging:		
Auditor remuneration - audit services	10	-

The Company's audit fee of £39,000 for the preceding year has been borne by its parent undertaking. Non audit fees provided to the Group are disclosed in the accounts of the parent company and the exemption from disclosure of fees payable to the Company's auditor in respect to non-audit services in these Financial Statements has been taken.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

12. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax charge for the year

	2019 £000	2018 £000
Current tax		
Corporation tax	3,985	801
Adjustment in respect of prior periods	(194)	-
Total current tax	3,791	801
Deferred tax (note 18)		
Origination and reversal of timing differences	8	-
Rate change	(1)	-
Total deferred tax	7	-
Tax charge on profit on ordinary activities	3,798	801

b) Factors affecting the tax charge for the year

	2019 £000	2018 £000
Profit before tax	20,742	3,844
UK corporation tax at 19% (2018: 19%) based on the profit for the year	3,941	730
Effects of:		
Non-deductable expenses	52	71
Prior year credit	(194)	-
Change in rate of taxation on deferred tax balances	(1)	-
Tax charge for the year	3,798	801

The current rate of corporation tax applicable to the Company for the year ended 30 September 2019 is 19.0%. Legislation had been enacted that would have reduced this to 17% with effect from 1 April 2020. Following the end of the year, in March 2020, the UK government substantively enacted legislation to rescind this reduction before it took effect.

Therefore, at 30 September 2019, the effective rate of corporation tax applicable to the company was expected to be 18% for the year ended 30 September 2020 and 17% thereafter. The deferred tax liability reflects the rate at which temporary differences are expected to reverse, based on the rates that had been substantially enacted at the year end.

The effect of the reversal of the rate cut on the Company's deferred tax balances will be accounted for in the year ending 30 September 2020, the year in which it took place.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

13. TANGIBLE FIXED ASSETS

	Computer equipment £000	Fixtures and fittings £000	Total £000
Cost			
At 1 October 2018	-	-	-
Transfered from subsidiary company	44	-	44
Additions	-	-	-
Disposals	-	-	-
At 30 September 2019	44	-	44
Accumulated depreciation			
At 1 October 2018	-	-	-
Transfered from subsidiary company	-	-	-
Charge for the year	16	-	16
Disposals	-	-	-
At 30 September 2019	16	-	16
Net book value			
At 30 September 2019	28	-	28
At 30 September 2018	-	-	-

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

14. FINANCIAL ASSETS

	2019 £000	2018 £000
Loans to customers (note 15)	424,603	252,592

The development finance loans have an average term of 20 months (2018: 21 months). Settlement of principal and accrued interest takes place once the development is sold or refinanced following its completion and the customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and / or property together with other charges and warranties related to the build.

Loans to customers is analysed as follows:

	2019 £000	2018 £000
Fixed assets	401,595	67,171
Current assets	23,008	185,421
	424,603	252,592

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

15. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

This note sets out information on the Company's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 14, which are classified as loans held at amortised cost, under IFRS 9.

The disclosures are set out under the following headings:

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

Basis of provision

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

15. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Calculation of expected credit loss ('ECL')

The loan book of the company contains a relative small number of loans and its historical loss level is such that a probability based model for defaults can not be derived. Due to the structure of the product, with no monthly payments required, days past due is also not a useful measure. Therefore the company's estimation of likely default relies on internal credit monitoring practices and professional credit judgement.

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

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

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Company's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Company assesses SICR primarily on the basis of its internal credit monitoring, which is updated regularly and includes credit data, project progress monitoring and account management amongst its inputs.

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

Definitions of default

The Company's definition of default for its loan portfolio is aligned to its internal operational procedures and the regulatory definitions of default used internally.

IFRS 9 provides a rebuttable presumption that an account is in default when it is ninety days overdue, however, as the company's accounts do not generally require regular payments to be made this is of limited application. A combination of qualitative and quantitative measures were used in developing the definition, including account management activities and internal statuses.

15. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Credit Impaired loans

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

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes. All default cases are considered to be credit impaired, even where such cases are being managed in the expectation of realising all of the carrying balance.

IFRS 9 Staging

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

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

On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date

Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan

For credit impaired assets, provisions will also be made on the basis of ECLs.

For assets which were 'Purchased or Originated as Credit Impaired' ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition) the carrying valuation is based on expected cash flows discounted by the EIR determined at the point of acquisition.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

15. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Impairments by stage

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

	Stage 1	Stage 2	Stage 3	POCI	Total
	£000	£000	£000	£000	£000
30 September 2019					
Gross loan book	381,927	30,741	-	13,242	425,910
Impairment provision	(820)	(487)	-	-	(1,307)
Total	381,107	30,254	-	13,242	424,603
Coverage ratio	0.21%	1.58%	-	-	0.31%
1 October 2018					
Gross loan book	237,876	-	-	14,715	252,591
Impairment provision	(56)	-	-	-	(56)
Total	237,820	-	-	14,715	252,535
Coverage ratio	0.02%	-	-	-	0.02%

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

15. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

Movements in impairment provision by stage

Accounts are considered to be written off for accounting purposes when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions. At 30 September 2019 enforceable contractual balances of £nil were outstanding on non-POCI assets written off in the period. This will exclude those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances will be kept under review for operational purposes but no amounts will be recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

A more detailed analysis of these movements by IFRS 9 stage for the year ended 30 September 2019 is set out below.

	Stage 1	Stage 2 *	Stage 3 *	POCI	Total
	£000	£000	£000	£000	£000
Loss allowance at 1 October 2018	56	-	-	-	56
New assets originated or purchased	824	-	-	-	824
Changes in loss allowance					
Transfer to stage 1	-	-	-	-	-
Transfer to stage 2	(7)	7	-	-	-
Transfer to stage 3	-	-	-	-	-
Changes due to credit risk	(53)	480	-	-	427
Write offs	-	-	-	-	-
Assets recognised	-	-	-	-	-
Changes in models/parameters	-	-	-	-	-
Loss allowance at 30 September 2019	820	487	-	-	1,307

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

15. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS (CONTINUED)

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

	Stage 1	Stage 2	Stage 3	POCI	Total
	£000	£000	£000	£000	£000
Balances at 1 October 2018	237,876	-	-	14,715	252,591
New assets originated or purchased	205,970	-	-	-	205,970
Changes in staging					
Transfer to stage 1	-	-	-	-	-
Transfer to stage 2	(24,357)	24,357	-	-	-
Transfer to stage 3	-	-	-	-	-
Redemptions, repayments and drawings	(69,436)	3,818	-	(2,192)	(67,810)
Assets recognised	-	-	-	-	-
Write offs	-	-	-	-	-
Other changes	31,874	2,566	-	719	35,159
Balance at 30 September 2019	381,927	30,741	-	13,242	425,910
Loss allowance	(820)	(487)	-	-	(1,307)
Carrying value	381,107	30,254	-	13,242	424,603

Other charges includes interest and similar charges.

Impairments charged to income

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

	2019 IFRS 9	2018 IAS 39
	£000	£000
Provided in period	2,647	45
Impairment on investments	259	373
	2,906	418

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

16. INVESTMENTS – LOANS TO GROUP COMPANIES

	2019 £000	2018 £000
Shares in subsidiaries at cost and valuation		
Balance at 1 October 2018 and 30 September 2019	-	-
Loans:		
Balance at 1 October 2018	50,685	-
Advances during the year	-	51,058
Impairment (note 15)	(259)	(373)
Balance at 30 September 2019	50,426	50,685
	50,426	50,685

The loans are to a subsidiary of the Company.

The subsidiary of the Company is Paragon Development Finance Services Limited. The principal activity of this subsidiary, which is wholly owned and registered in England and Wales, is the provision of servicing the loan book.

Group accounts have not been prepared as the Company is itself a wholly owned subsidiary and its results are consolidated by the parent company (note 23). The directors consider the investment to be worth at least the amount stated.

17. DEBTORS

	2019 £000	2018 £000
Amounts falling due within one year:		
Deferred tax (note 18)	3	-
Prepayments and accrued income	75	376
	78	376

18. DEFERRED TAX

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

	2019 £000	2018 £000
Balance at 1 October 2018	-	-
Profit and loss charge (note 12)	(8)	-
Rate change (note 12)	1	-
Change in accounting policy on adoption of IFRS9 (note 3)	10	-
Balance at 30 September 2019	3	-
The net deferred tax asset for which provision has been made is analysed as follows:		
Other timing differences	3	-

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

19. CALLED UP SHARE CAPITAL

	2019 £	2018 £
Allotted:		
80,000,001 (2018: 1) ordinary share of £1 each (fully paid)	80,000,001	1

During the year 80,000,000 (2018: nil) Ordinary shares of £1 each were subscribed for at par by the parent company.

20. PROFIT AND LOSS ACCOUNT

	£000
At 1 October 2017	(100)
Profit for the financial year	3,043
Cancellation of shares	100
At 30 September 2018	3,043
Profit for the financial year	16,944
Change in accounting policy on adoption of IFRS9	(47)
At 30 September 2019	19,940

The directors do not propose an interim or final dividend (2018: £nil).

21. CREDITORS

	2019 £000	2018 £000
Amounts falling due within one year:		
Amounts due to group companies	374,595	299,881
Corporation tax	4,046	801
Accruals and deferred income	1,238	415
	379,879	301,097

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2019

22. 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, 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.