

Prime RMBS
United Kingdom
Special Report

Impact of Expected Housing Market Deterioration on UK Prime RMBS Ratings

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Related Research

- *"Impact of Declining House Prices on UK Non-conforming Ratings"*, November 2008
- *"Ratings Stress Test: Impact of UK Housing Market Downturn Scenarios on UK Non-Conforming RMBS Ratings"*, July 2008
- *"Masters of the House - A Review of UK RMBS Master Trusts"*, June 2005
- *"Adverse Credit Labels in UK Non-Conforming RMBS"*, February 2007

Summary

- This report examines the impact of Fitch Ratings' expected UK housing market deterioration on outstanding UK prime RMBS ratings for both pass-through transactions and master trust programmes.
- As the UK housing market has continued to deteriorate, Fitch expects a peak-to-trough UK house price decline of around 30% over a three-year period as published in its November report, *"Impact of Declining House Prices on UK Non-conforming Ratings"*. Prices began declining in October 2007 and are not expected to stabilise until 2010.
- With evidence increasingly pointing towards a UK recession of the magnitude last seen in the previous recession of the early 1990s, the analysis also factored in increasing defaults based on the performance of prime mortgages during this period.
- For UK prime pass-through transactions, this exercise purely assesses the impact of falling house prices and increasing defaults on existing ratings. This analysis does not stress the full range of factors considered by Fitch as part of the rating or surveillance process; for example, the impact of delinquencies and the availability of excess spread is excluded. Consequently, the results of this study are intended to be indicative of potential rating movements.
- The agency found that under such stress, the ratings of UK prime pass-through transactions show minimal ratings volatility whereby 99.4% of notes by value are expected to maintain their existing rating whilst 0.6% are vulnerable to downgrade. This analysis triggered the full rating review of three transactions, following which, Fitch placed three 'A' rated notes issued by Paragon 14 and Paragon 15 on rating Outlook Negative (as detailed in *Appendix 1* and related Rating Action Commentaries).
- By contrast, due to the complex nature of master trust transactions, an in-depth cash-flow analysis has been performed for each programme whereby the ratings were further stressed assuming the occurrence of a number of possible events, including, but not limited to, various prepayment speeds, the inability of originators to replenish the trusts and a breach of a non-asset trigger. For these programmes, Fitch found that under such stress, negative rating migration is expected to be minimal and confined to the lower rated tranches, which is not unanticipated given that subordinated notes are designed to withstand significant market deterioration before any impact is seen at higher rating levels. Whilst notes assigned a rating greater than 'BBB' remain stable, 62% of the total outstanding 'BBB' notes by value and 75% of the total outstanding 'BBB' notes by value face potential ratings migration.
- In order to determine ultimate rating actions for the master trust programmes, the agency further investigated each transaction highlighted in this study as being susceptible to downgrade, particularly with regards to current asset performance trends. Accordingly, Fitch has placed 40 'BBB' tranches and three 'BB' tranches issued from Granite, Aire Valley and Lanark on rating Outlook Negative in addition to downgrading the three 'BB+' and three 'BBB+' notes

issued by Whinstone and the two 'BB' notes issued by Whinstone 2 (as detailed in *Appendix 1* and related Rating Action Commentaries).

Introduction

The rapid intensification of the global credit crisis over the past few months culminating in the partial or total nationalisation of a number of European banks, in combination with clearer evidence of household retrenchment and rising job uncertainty, have led to a sharp deterioration in the agency's outlook for the UK mortgage market. These factors look to outweigh the expansion of the Bank of England liquidity provisions, the major fiscal injections into the UK banking system and the interest rate cuts executed by the Bank of England in 2008 and 2009, which have eased affordability pressures for those borrowers who have received the benefit of such policy cuts.

An economic downturn driven by a contraction in the supply of credit is uncharted territory for the UK economy and there are few historical parallels on which to gauge its possible length or depth. Notwithstanding, it is evident from the continued contraction in the supply of mortgage credit together with the strain on affordability intensified by rising unemployment, that a recession of the magnitude witnessed in the early 1990s, or worse, is a distinct possibility, and with it, a housing market correction of a similar or even greater quantum (according to the Nationwide House Price Index, nominal house prices decreased by approximately 20% from peak-to-trough from 1989 through to 1993).

To assess the potential impact of such deterioration in the UK housing market on UK prime¹ RMBS ratings, Fitch has examined a scenario of declining house prices accompanied by increasing defaults. The agency found that senior notes are resilient to its expected UK housing market deterioration and are expected to maintain their existing ratings. Negative rating migration is minimal and confined to the lower rated tranches.

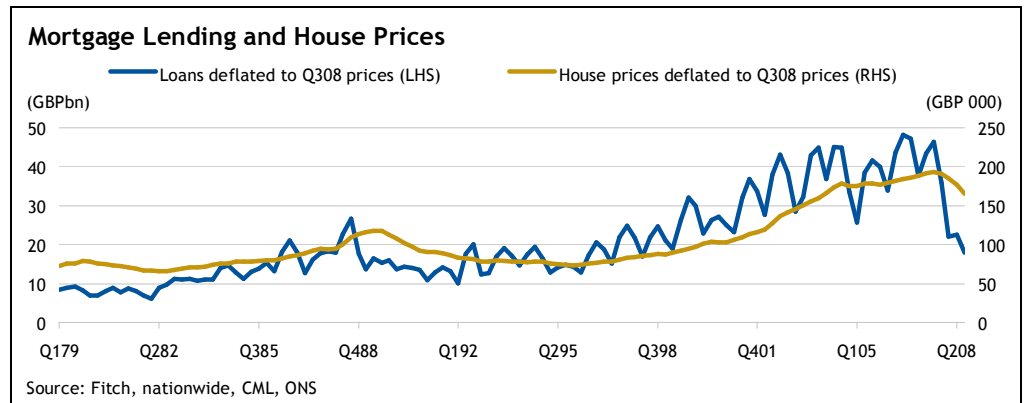
Outlook for UK House Prices

In the 10 years preceding 2007, the UK experienced one of the most rapid real house price growth periods of any developed country; however, since the onset of the credit crunch, which materialised in the summer of 2007, house price inflation has abated considerably. The UK economy is now formally in recession with Fitch forecasting a 1.4% decline in GDP in 2009 and, despite the implementation of a number of measures aimed at encouraging market activity, the outlook for the housing market remains bleak.

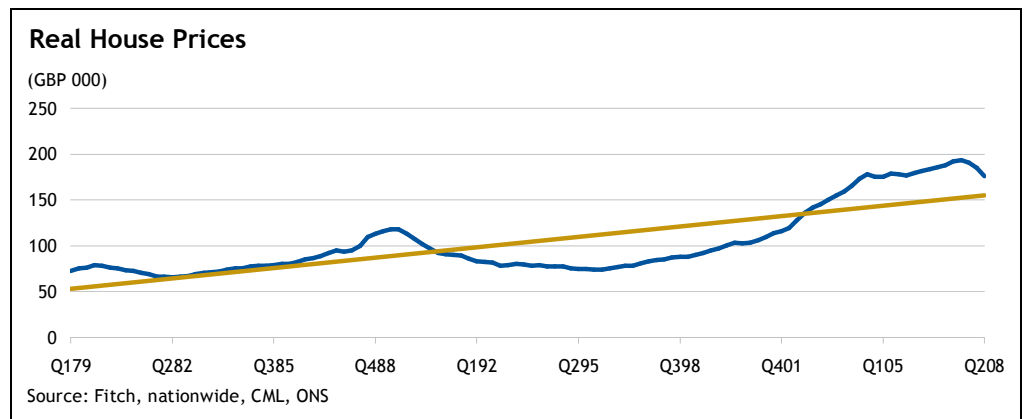
The Bank of England's Q3 2008 Credit Conditions Survey indicates that lenders have reported a sharp decline in demand for secured lending with the expectation that demand will likely fall further. This survey is backed up by data from the Council of Mortgage Lenders, which has recently indicated that gross mortgage lending in November 2008 was approximately 50% of that achieved in November 2007 with net mortgage lending likely to turn negative in 2009. Weaker housing demand, driven by the decline in the availability of mortgage finance together with high property prices relative to earnings, muted income growth and the strains on disposable income have put downward pressure on house prices, which will likely be exacerbated by the weakening labour market. Furthermore, these factors have deterred first-time buyers from entering the market.

According to the Nationwide Building Society and Halifax, UK house prices have fallen from their peak in 2007 by around 15%-18%, and since March 2008, house prices have fallen faster than at any time since the recession of the early 1990s. It is widely predicted that even further declines will occur over a longer timeframe.

¹ Fitch's definition of "prime" is consistent with that clarified in its February 2007 report "*Adverse Credit Labels in UK Non-Conforming RMBS*"



The agency’s central expectation is of a peak-to-trough decline of 30%, in nominal terms, over a three-year period, bringing the “house price to household disposable income” ratio broadly into line with its long-term average and representing a similar decline in real terms to that witnessed in the early 1990s. With house prices already suffering a 15%-18% decline since their peak in October 2007, the implication is of a further 12%-15% decline over the next two years.

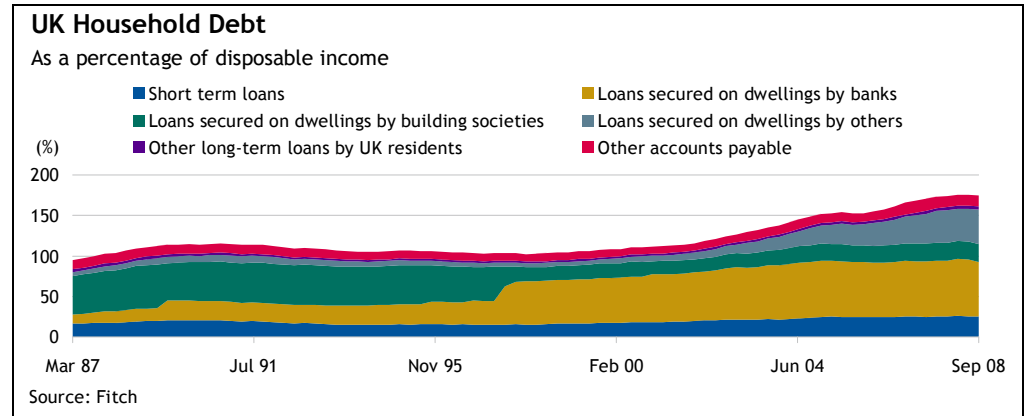


Performance Outlook & Determining Default Rates

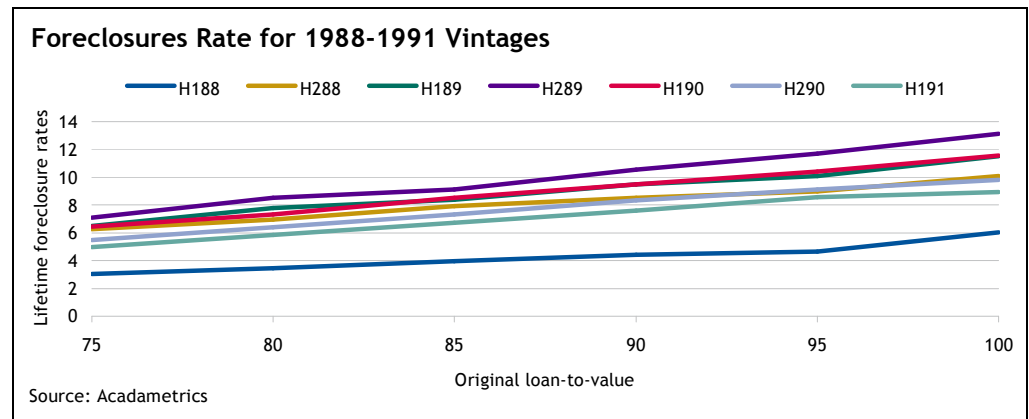
Repossession levels within UK prime transactions have historically been minimal following the benign economic environment prior to the summer of 2007, which was characterised by low unemployment and low inflation. However, successive interest rate rises in 2006 and 2007, coupled with the severe dislocation of the mortgage market, led to affordability constraints, which fed through to higher delinquencies. Despite the implementation of a number of government measures aimed at stimulating economic activity together with the Bank of England’s decision to reduce interest rates in 2008 and 2009, which eased affordability pressures for existing borrowers and encouraged potential homebuyers, a number of factors remain, which are likely to lead to a significant deterioration in arrears performance.

Household incomes have been squeezed by food and energy prices, which have soared in excess of salary increases. This effect has been amplified as lenders have tightened the terms on which they are prepared to offer credit, particularly for higher risk borrowers. Notwithstanding, the Bank of England base rate cuts have resulted in mortgages becoming progressively cheaper for existing variable-rate borrowers. Nationwide estimates that approximately one-third of borrowers on tracker rate mortgages have benefited fully from the base rate cuts, whilst most lenders have passed a large part of the interest rate cuts on to those borrowers who are on standard variable rate deals. Although borrowers with fixed-rate mortgages have yet to benefit from such policy cuts, the payment shock faced upon the expiry

of such deals is likely to be substantially less. Nevertheless, the 2008 NMG survey, carried out in the midst of the financial crisis on behalf of the Bank of England, established that for more than half of households surveyed, the aggregate effect on household finances was a decline in disposable income. Household debt levels are now significantly higher than in the last recession and affordability is stretched, a situation that will likely be compounded as the unemployment rate rises. These borrowers will be exposed to temporary loss of income, which will inevitably lead to an increase in the number of households facing mortgage arrears and repossession.



Despite household indebtedness being significantly higher than that observed in the recession of the early 1990s, interest rates are substantially lower. Furthermore, Fitch expects unemployment to rise to 7.3% in 2009 and 7.9% in 2010, which is somewhat less than the peak of 10.2% endured in 1993. However, with evidence increasingly pointing towards a UK recession of the magnitude witnessed in the recession of the early 1990s, the analysis also factored in base defaults assumed to be in the region of that observed during the aforementioned period.



Data available from various UK prime lenders and the independent consultancy, Acadametrics, indicate that within this recession, the average lifetime default rate for a prime loan with an LTV in the region of 75%-80% and a debt-to-income of 25%-30% was approximately 6%.

Methodology

To understand the impact of the agency's expected UK housing market deterioration on 146 collateralised tranches in 20 Fitch-rated UK prime owner occupied and buy-to-let (BTL) pass-through transactions that closed prior to 2008 and 611 collateralised tranches in the 12 Fitch-rated master trust programmes that remained outstanding as at 31 December 2008, Fitch employed the following methodology:

1. **Step 1:** Derive the expected loss each pool would suffer over a two-year period using the weighted-average default probability and weighted-average recovery rate calculated by applying such stress.
2. **Step 2:** Forecast credit enhancement (CE) for each tranche in two years time by applying these losses to each pass-through transaction. Master trust programmes were further stressed assuming varying replenishment volumes and prepayment speeds in addition to the occurrence of a non-asset trigger.
3. **Step 3:** Determine the revised rating for each tranche based on forecast CE.

Step 1: Loss Estimation

On a portfolio basis, the expected loss the pool is expected to suffer over a two-year period is expressed as a product of the weighted-average default probability (otherwise referred to as the weighted-average foreclosure frequency (WAFF)) and 1 minus the weighted-average recovery rate (otherwise referred to as the WARR). In contrast to the weighted-average loss severity (WALS), the WARR gives credit to the fact that the lender may be able to recover accrued interest in excess of the principal amount outstanding that would be available to noteholders. In using the WARR, Fitch has thus allowed each transaction to benefit from the recovery of interest where equity in the property permits.

Default Estimation

During the recession of the early 1990s, data from a number of sources indicates that the average default rate for a prime loan with an LTV in the region of 75%-80% and a debt-to-income of 25%-30% was approximately 6%.

The agency re-calibrated the UK prime base default probability matrix around this foreclosure approximation and subsequently performed its full loan-by-loan analysis outlined in the “*UK Residential Mortgage Default Criteria*” to determine the ultimate default probability (the base default probability adjusted to account for adverse borrower and credit characteristics) for each of the 12 master trust programmes.

Due to the significant number of outstanding UK prime pass-through transactions, a simplified approach was adopted, whereby the default probability for each portfolio was estimated by comparing the pool composition in its entirety against a hypothetical reference pool with a weighted-average LTV of 75%, DTI of 25% and a default probability of 6%, among other things. The ultimate foreclosure frequency was derived by scaling the default probability assigned to the reference pool based on its asset quality. Consequently, a pool exhibiting credit characteristics of a more adverse nature would attract a higher default rate.

Loss Severity Estimation

Fitch’s expectation is of a further 12% - 15% house price decline over the next two years, with significant regional variations. This analysis examines the probable impact of such house price depreciation in addition to a quick sale adjustment of 10% to account for the reduced saleability and liquidity of foreclosed properties in distressed markets resulting in lower than average sale prices.

Fitch recalculated its market value decline (MVD) assumptions based on this prediction and used existing regional differentials to approximate future geographical developments. Using these revised MVDs, Fitch completed its full loan-by-loan analysis to derive the WARR for each of the 12 master trust programmes.

Following the approach adopted above for the pass-through transactions, WARRs for each pool were estimated by comparing their regional composition with that of the reference portfolio. The agency is of the opinion that any house price correction is likely to be more pronounced within the London, Outer Metro and South East areas, consequently, a pool with a higher concentration in these regions will be expected to experience a greater decline in property prices. Furthermore, to account for a

degree of adverse selection among defaulting loans, Fitch has assumed that borrowers with the highest LTV ratios will account for 50% of all defaults, resulting in higher than expected loss severities. The remaining 50% of defaults are assumed to have an LTV equal to the average LTV of the relevant pool.

Expected Loss

The table below provides an indication of the default (WAFF), loss severity (WALS) and recovery rates (WARR) calculated as part of this analysis, split between pass-through transactions and master trust programmes.

Default Probability, Loss Severity & Recovery Rates

(%)	Average				
	WAFF	WALS	WARR	WAFF * WALS	WAFF * (1-WARR)
Master trust programmes	10.7	23.7	84.3	2.3	1.6
Pass-through transactions	7.8	21.3	87.2	1.8	1.3

Source: Fitch

Step 2: Forecasting Credit Enhancement

For pass-through transactions, Fitch forecasted the available CE for each tranche over a two-year period by applying the expected loss calculated using the methodology above, towards a reduction in the CE calculated at closing. Due to the complex nature of master trust programmes, an in-depth cash flow analysis has been performed for each programme whereby CE was further stressed by applying varying prepayment speeds and replenishment assumptions in addition to simulating a non-asset trigger event.

Pass-Through Transactions

For each pass-through transaction, this analysis estimates the impact of the expected decline in house prices in combination with increasing defaults on the level of credit enhancement available to each tranche in two years time. Defaults are assumed to materialise immediately, whilst losses will be crystallised by the end of the two-year cycle. Moreover, in forecasting the level of credit enhancement for transactions where notes are currently redeemed sequentially, the agency has attempted to account for the dramatic decline in the prepayment rates as evidenced in a number of UK prime pass-through transactions. In stressing the prepayment rates, the extent to which the transaction de-levers and the speed at which credit enhancement builds up reduces.

Importantly, this analysis does not consider all the factors Fitch would consider as part of the rating or surveillance process. For example, the impact of delinquencies and the availability of excess spread, which is a key source of credit support and liquidity, are excluded. Consequently, the results of this study are intended to be indicative of potential rating movements.

Master Trust Programmes

In contrast to the traditional RMBS construction where principal receipts are usually distributed to noteholders on a pass-through basis, master trusts are highly structured whereby both the originator and the noteholders have an interest in the trust property and note redemption and principal distribution is more complex. The mortgages trustee typically allocates principal cash flows to the Funding beneficiaries, which represent the aggregate noteholder interest, based on the lesser of their cash accumulation and repayment requirement and their respective shares. If the cash accumulation and repayment requirement is greater than the amount calculated based on their respective shares, any excess principal will be further allocated to the Funding beneficiaries with the surplus being paid to the seller to the extent that the seller share is greater than the minimum seller share.

Non-Asset Trigger

Notwithstanding, non-asset triggers feature within these programmes and are designed to accelerate the repayment of senior notes before any problems arise within the loan portfolio and structure. This is achieved by modifying the structural mechanics of the programme, allowing principal that would otherwise have been paid to the originator, to flow to the noteholders. Non-asset trigger events include the insolvency of the originator, failure to maintain the minimum seller share and the reduction of the trust property below the requirement. To activate a non-asset trigger event resulting from seller insolvency, the agency simulated an originator default at various points throughout the two-year timeframe considered.

Substitution

Although originators are under no obligation to substitute loans into the trust, these transactions are often dependent upon substitutions to maintain the minimum trust size, where applicable, and sustain the minimum seller share, thus avoiding a non-asset trigger. In ceasing to assign new loans to the Granite Master Trust programme, Northern Rock (NR) failed to prevent the non-asset trigger that was breached in November 2008, resulting in the accelerated repayment of notes. The probability of this scenario occurring within other programmes will be determined by a number of factors, primarily, future funding strategies and the ability of lenders to sell new loans into the trusts. The degree to which lenders can replenish is dependent upon the extent to which eligible unencumbered mortgages remain outstanding on their balance sheet, which may be hampered by any tightening of underwriting criteria, which ultimately results in a decline in origination volumes. Furthermore, the seller may be prohibited from assigning new loans to the programme following a breach of the substitution conditions as is currently the case in the Aire Valley programme. The impact of substitution is such that it cannot be ignored for the purposes of this analysis. Consequently, with the exception of Granite and Aire Valley whereby substitution is no longer permitted, each programme was stressed assuming that prior to a breach of the substitution criteria, new loans were assigned to the extent required to maintain the minimum trust size, where such a feature exists, and the minimum seller share. Following a breach of the criteria, which include but are not limited to, a non-asset trigger and various pool performance factors, substitution is stopped.

Prepayment

High prepayment, alone or in combination with low substitution volumes, may lead to the seller share reducing at a faster rate than the Funding share, risking a breach of a non-asset trigger. However, since the onset of the liquidity crisis, there has generally been a marked decline in annualised prepayment rates. Whilst the reduction in the prepayment rate reduces the speed at which the trust size declines, it may cause certain classes of notes to be repaid less rapidly than expected and could result in some notes extending past their step-up dates in the absence of being refinanced. Following a step-up date, all relevant notes are reclassified as pass-through notes and are entitled to receive their pro-rata share of principal only.

When bullet and scheduled amortisation notes are issued, transactions are structured to ensure that the mortgages trustee accumulates sufficient principal receipts to redeem the scheduled amount in full in advance of such payment. This involves a cash accumulation period that is set to occur a predetermined number of months in advance of such a payment date, assuming that principal repayment rates from the mortgage collateral are maintained at a certain prearranged level. Generally speaking, if repayment rates fall below the required level during an estimated period, usually 12 months, before the scheduled payment date, the cash accumulation period will begin at the start of that period rather than later. This increases the cash accumulation requirement and hence affects the principal distribution between the beneficiaries. Slow prepayment poses an additional complication such that below a certain level, principal deferral to junior notes is

permitted. Accordingly, the agency has further stressed each programme by applying various prepayment speeds, including scenarios where the prepayment rate is assumed to slow considerably.

Given the complex nature of master trust programmes, an in-depth cash flow analysis has been performed for each programme. In addition to estimating the impact of the expected decline in house prices in combination with increasing defaults on the level of credit enhancement, the ratings were further stressed assuming the occurrence of a number of possible events, including, but not limited to, a breach of a non-asset trigger, the inability of originators to replenish the trusts and various prepayment speeds. Defaults are assumed to occur evenly over the two-year period whilst losses crystallise immediately. As a full cash-flow analysis was completed, the impact on liquidity of delinquencies and the availability of excess spread was considered.

Step 3: Determine Rating Transition

The CE calculated at the end of this two-year period is used to determine the revised rating. The agency assumes that the CE available to each tranche would need to be in the region of that required to achieve the initial rating. As an illustration, assume three notes are issued, which are assigned a 'AAA', 'AA' and 'A' rating, whereby at closing, the credit enhancement available to each tranche is 9.1%, 6.9% and 5.1%, respectively. To estimate the credit enhancement needed to obtain a rating of 'AA+', the agency has linearly interpolated between the levels required to achieve a 'AAA' and a 'AA' rating, such that credit enhancement of 8.0% is necessary. In estimating the credit enhancement needed to obtain a rating of 'AA-' or 'A+', the agency has linearly interpolated between the levels required to achieve a 'AA' and a 'A' rating, such that credit enhancement of 6.3% and 5.7% is necessary.

For the 'AAA' tranche to maintain its rating, Fitch has assumed that the revised credit enhancement levels must be equal to, or greater than the mid point between the 'AAA' and 'AA+' credit enhancement levels calculated at closing, of 8.5%. To attain a 'AA+' rating, credit enhancement levels must be equal to, or greater than the mid point between the 'AA+' and 'AA' credit enhancement levels calculated at closing, of 7.4%. In this example, should the credit enhancement available to the 'AAA' tranche, as calculated at the end of the two-year timeframe, drop to 7.8%, the 'AAA' rating would be assumed to migrate to 'AA+'.

Results

The following tables aggregate the rating transitions that are expected to occur within UK prime pass-through transactions and master trust programmes as a result of the agency's expected deterioration in the UK housing market.

UK Prime Transactions

Possible rating migration based on value of tranches

Current rating	Revised rating (%)						CCC
	AAA	AA (+/-)	A (+/-)	BBB (+/-)	BB (+/-)	B (+/-)	
AAA	100	-	-	-	-	-	-
AA (+/-)		100	-	-	-	-	-
A (+/-)			94	6	-	-	-
BBB (+/-)				44	54	2	-
BB (+/-)					26	30	44

Source: Fitch

UK Prime Transactions

Possible rating migration based on number of tranches

Current rating	Revised rating (%)						CCC
	AAA	AA (+/-)	A (+/-)	BBB (+/-)	BB (+/-)	B (+/-)	
AAA	100	-	-	-	-	-	-
AA (+/-)		100	-	-	-	-	-
A (+/-)			95	5	-	-	-
BBB (+/-)				69	29	2	-
BB (+/-)					33	25	42

Source: Fitch

Pass-Through Transactions

Fitch tested the ratings of all prime UK pass-through transactions that remained outstanding as at 31 December and closed prior to 2008, against a decline in UK house prices of approximately 30% from their peak in October 2007, factoring in increasing defaults based on the performance of prime mortgages during the recession of the early 1990s. The analysis shows that prime pass-through ratings are very well positioned to withstand such stress with ratings remaining Stable in the majority of cases, as demonstrated in the following tables. In terms of value, only 0.6% of notes show a rating downgrade whilst tranches with a rating greater than 'A' are not expected to migrate. This is expected given the progressively severe stress a highly rated note must withstand to be assigned an initial rating.

UK Prime Pass-Through Transactions

Possible rating migration based on value of tranches

Current rating	Revised rating (%)						CCC
	AAA	AA (+/-)	A (+/-)	BBB (+/-)	BB (+/-)	B (+/-)	
AAA	100	-	-	-	-	-	-
AA (+/-)		100	-	-	-	-	-
A (+/-)			78	22	-	-	-
BBB (+/-)				100	-	-	-
BB (+/-)					100	-	-

Source: Fitch

UK Prime Pass-Through Transactions

Possible rating migration based on number of tranches

Current rating	Revised rating (%)						CCC
	AAA	AA (+/-)	A (+/-)	BBB (+/-)	BB (+/-)	B (+/-)	
AAA	100	-	-	-	-	-	-
AA (+/-)		100	-	-	-	-	-
A (+/-)			78	22	-	-	-
BBB (+/-)				100	-	-	-
BB (+/-)					100	-	-

Source: Fitch

Notwithstanding, in the case of the UK prime pass-through transactions, this analysis does not consider all the factors Fitch would consider as part of the rating or surveillance process and, as such, the results are intended to be indicative of potential rating movements. When interpreting the results, the following limitations should be considered:

- **Recovery Estimation:** The estimation of the recovery rate, used to determine the expected loss, assumes that borrowers with the highest LTV ratios will account for 50% of all defaults. The LTV of defaulting loans could be markedly different.
- **Default Timing:** Defaults are conservatively assumed to occur immediately whilst losses crystallise at the end of the two-year timeframe analysed.

Historical evidence infers a default vector spanning a longer period.

- **Timeframe:** This analysis purely addresses the impact of falling house prices and increasing defaults on credit enhancement over the next two years rather than across the lifetime of the transaction, which is the approach employed at the time of assigning initial ratings.
- **Expected Housing Market Deterioration Analysed in Isolation:** This study does not stress the full range of factors considered as part of the rating or surveillance process. For example, the impact of delinquencies and the availability of excess spread are excluded.
- **Transaction Specifics:** A stressed economic environment could create disproportionate pressure on some transactions. While the agency has attempted to differentiate the expected loss based on pool composition, the actual losses may vary from that estimated in this analysis. Furthermore, structural features differ between transactions such that each transaction may respond in a unique way to a weakening housing market.

Given the limitations of this analysis, a full review following the agency's standard methodology has been conducted on the three transactions identified in this analysis as "at-risk", following which, Fitch placed three 'A' rated notes issued by Paragon 14 and Paragon 15 on Rating Outlook Negative (as detailed in *Appendix 1* and related Rating Action Commentaries).

Loss Coverage Analysis

The robustness of UK prime pass-through ratings has been tested against the agency's house price and performance predictions, which result in the following default and loss severity expectations by vintage.

Default and Loss Severities by Vintage^a

Transaction vintage (%)	Average		Maximum		Minimum	
	Defaults	Loss severity	Defaults	Loss severity	Defaults	Loss severity
2007	8.7	23.4	12.1	31.5	5.2	7.0
2006	6.7	17.9	7.5	20.7	5.6	15.3
2005	5.3	13.8	6.5	13.8	4.0	13.8
Pre-2005	5.4	5.1	6.9	9.3	4.4	-

^a For a 30% peak to trough decline in UK house prices
Source: Fitch

The actual level of defaults and loss severities that will be suffered are likely to differ from those envisaged. Consequently, the agency supplemented the above analysis by calculating the loss necessary to trigger a default on the 'AAA' rated notes. This was achieved by estimating the expected loss associated with varying levels of defaults and house price declines and comparing the results with the credit enhancement available to the 'AAA' tranches. As an example, assuming a default rate of 10% and a peak-to-trough house price decline of 30%, the expected loss for a pool is estimated at 2%. The credit enhancement available to the respective 'AAA' note is 12%, such that the loss coverage is 6x.

The table below shows the "AAA" loss coverage across prime transactions originated from 2003 to 2007. Loss coverage varies by vintage as more seasoned deals have built up greater level of credit enhancement and hence could take a greater amount of loss before a default occurring. Please refer to *Appendix 2* for detailed loss coverage tables by vintage.

"AAA" Loss Coverage - 2003 to 2007 Vintage

WA expected defaults ^a (%)	7.8
WA expected loss severity ^a (%)	21.3
WA loss required to cause 'AAA' default (%)	15.3
Current 'AAA' loss coverage ^a (x)	9.2

^a Fitch expectation for a 30% peak to trough house price decline
Source: Fitch

'AAA' Loss Coverage - 2003 to 2007 Vintage

Default rates (%)	Peak to trough house price decline (x)								
	30	35	40	45	50	55	60	65	70
6	12.0	9.7	8.2	7.0	6.2	5.5	5.0	4.5	4.2
8	9.0	7.3	6.1	5.3	4.6	4.1	3.7	3.4	3.1
10	7.2	5.8	4.9	4.2	3.7	3.3	3.0	2.7	2.5
12	6.0	4.9	4.1	3.5	3.1	2.8	2.5	2.3	2.1
15	4.8	3.9	3.3	2.8	2.5	2.2	2.0	1.8	1.7
20	3.6	2.9	2.4	2.1	1.9	1.7	1.5	1.4	1.3
25	2.9	2.3	2.0	1.7	1.5	1.3	1.2	1.1	1.0
30	2.4	1.9	1.6	1.4	1.2	1.1	1.0	0.9	0.8

Source: Fitch

Master Trust Programmes

The agency tested the ratings of all 611 outstanding notes issued from the 12 Fitch-rated prime UK master trust programmes that remained outstanding as at 31 December 2008 in addition to the two synthetic transactions, Whinstone Capital Management Limited (Whinstone) and Whinstone 2 Capital Management Limited (Whinstone 2), which reference the performance of the reserve funds acting as credit enhancement for the capitalist issuances from Granite Finance Funding Limited (Funding) and the performance of Granite Finance Funding 2 Limited (Funding 2) reserve fund and the Granite Master Issuer (GMI) reserve fund.

Fitch has evaluated the collateral of each programme on a loan-by-loan basis using its default model, modified to account for the agency's house price and default rate predictions. Due to the complex nature of master trust transactions, an in-depth cash flow analysis has been performed for each programme whereby the ratings were further stressed assuming the occurrence of a number of possible events, including, but not limited to, various prepayment speeds, the inability of originators to replenish the trusts and a breach of a non-asset trigger. The analysis shows that senior notes assigned a rating greater than 'BBB' are resilient to the agency's expected UK housing market deterioration and are expected to maintain their existing ratings, as shown in the following tables. Negative rating migration is confined to the 'BBB' and 'BB' rated notes whereby 62% of the total outstanding 'BBB' notes by value and 75% the total outstanding 'BB' notes by value face the possibility of downgrade.

UK Master Trust Programmes

Possible rating migration based on value of tranches

Current rating	Revised rating (%)						CCC
	AAA	AA (+/-)	A (+/-)	BBB (+/-)	BB (+/-)	B (+/-)	
AAA	100	-	-	-	-	-	-
AA (+/-)		100	-	-	-	-	-
A (+/-)			100	-	-	-	-
BBB (+/-)				38	60	2	-
BB (+/-)					25	31	44

Source: Fitch

UK Master Trust Programmes

Possible rating migration based on number of tranches

Current rating	Revised rating (%)						CCC
	AAA	AA (+/-)	A (+/-)	BBB (+/-)	BB (+/-)	B (+/-)	
AAA	100	-	-	-	-	-	-
AA (+/-)		100	-	-	-	-	-
A (+/-)			100	-	-	-	-
BBB (+/-)				66	31	3	-
BB (+/-)					27	27	46

Source: Fitch

A thorough default and cash-flow analysis was performed for each programme, nevertheless, when interpreting the results, readers should consider that for the purpose of this analysis, credit enhancement availability at the end of a two-year timeframe was used to infer rating movements. This differs from the approach taken when assigning initial ratings, which address the timely payment of interest and ultimate payment of principal by legal final maturity. Importantly, this methodology conservatively assumes that defaults occur evenly over 24 months whilst losses crystallise immediately and further disregards the availability of excess spread over the remaining life of the transaction. The level of excess spread is dependent upon the performance of the pool and, as such, is likely to be least available throughout the period considered; however, it has the advantage of being a potentially ongoing resource that can be used as future credit support and liquidity for all rated notes.

Consequently, to determine ultimate rating action, the agency further investigated each transaction highlighted in this study as being susceptible to downgrade. Accordingly, Fitch has placed 40 'BBB' tranches and three 'BB' tranches issued from Granite, Aire Valley and Lanark on rating Outlook Negative in addition to downgrading the three 'BB+' and three 'BBB+' notes issued by Whinstone and the two 'BB' notes issued by Whinstone 2 (as detailed in *Appendix 1* and related Rating Action Commentaries). The subsequent paragraph explains the rating actions taken by Fitch, particularly in relation to Granite and Aire Valley, which have recently been the focus of much attention.

Rating Action - Master Trusts

Granite

Granite comprises five outstanding capitalist issuances from Granite Finance Funding Limited (Funding) and 10 outstanding series issued from Granite Master Issuer plc through the second beneficiary, Granite Finance Funding 2 Limited (Funding 2). In November 2008, Granite breached a non-asset trigger, which ensued as a result of the seller share being less than the minimum required seller share for two consecutive monthly distribution dates. Consequently, the trust has begun to unwind and repayment has been accelerated.

Although arrears performance has worsened for the UK mortgage market as a whole, the credit performance of the underlying mortgage collateral backing Granite has deteriorated at a faster pace in comparison to its master trust peers, exacerbated by the shrinking of the mortgage book as the higher quality end of the portfolio has re-mortgaged with other lenders, in addition to the strengthening of NR's mortgage arrears capitalisation policy whereby the ability to capitalise arrears where borrowers have made less than three monthly payments has been removed. This situation is likely to be compounded as a result of the non-asset trigger breach, which prohibits NR assigning new loans to the trust, which has the effect of diluting the level of arrears.

Fitch expect this arrears trend to continue, driven by Granite's higher than average exposure to both high LTV mortgages and the Together product, in conjunction with the adverse selection that has arisen as a result of the aggressive redemption policies pursued by NR in 2008. NR's commercial strategy, approved by HM Treasury in March 2008, had as its priority the repayment of the facilities provided by the Bank of England through the contraction of the balance sheet, to be achieved primarily from accelerating the pace of mortgage repayments. To aid this process, NR actively encouraged borrowers to refinance elsewhere in addition to entering into a three-year agreement with Lloyds TSB in June 2008 under which NR began actively providing its fixed-rate maturing customers, with a maximum loan-to-value of 80%, with the opportunity to apply for a Lloyds TSB mortgage from July. On 19 January 2009, the government announced that NR will no longer pursue a policy of rapidly reducing its mortgage book; however, the trust is still vulnerable to adverse selection by nature of the fact that the higher quality end of the Granite portfolio

will find it easier to refinance with other lenders, which may manifest in a further deterioration in the credit quality of Granite.

Notwithstanding the negative implications of adverse selection, lower quality borrowers who are unable to refinance with other mortgage lenders will move onto NR's standard variable rate (SVR) once their fixed or discounted periods have come to an end. Indeed, following the severe dislocation in the mortgage market, there has been a noticeable increase in the proportion of SVR loans and a corresponding decrease in fixed-rate loans within Granite. The increase in the percentage of SVR loans has ultimately had a positive impact on the weighted-average post swap margin earned on the assets due to the higher spread earned on the SVR loans from the funding swaps.

Fitch's anticipated deterioration in the UK housing market is not expected to threaten the credit ratings assigned to the notes issued by Funding which adopted a 'capitalist' structure whereby each issuer has its own principal deficiency ledger and own exclusive reserve fund which is available solely to support the notes issued as part of that particular transaction. This deterioration is mitigated by credit enhancement levels, which have risen considerably since closing given the non-amortising nature of the reserve funds, historically good underlying asset performance and the principal paydown on the respective notes, allowing expected losses to be comfortably absorbed by excess spread and the respective reserve funds. Consequently, the ratings of all outstanding notes issued from Funding have been affirmed.

This is in contrast to the credit enhancement levels within the master issuer from Granite Finance Funding 2 Limited, which have typically remained static, a phenomenon that arises as a result of its de-linked structure, whereby credit enhancement for each transaction is provided by all newly issued and previously issued outstanding subordinate notes, together with the Funding 2 and master issuer reserve funds. However, given the absence of new issuance since September 2007, the credit enhancement has accumulated as Funding 2 notes have repaid, which is particularly apparent following the accelerated redemption of notes caused by the non-asset trigger breach. Further credit enhancement was provided following the increase in the Funding 2 reserve fund which was required in November 2008 after the balance of loans more than three months in arrears exceeded the 2% threshold. Moreover, the observed increase in excess spread provides additional protection for Granite and enables a greater proportion of losses to be absorbed prior to drawing on the reserve funds.

Notwithstanding, the agency envisages the prepayment speed slowing following the government announcement referred to above, which will have the effect of reducing the pace at which the notes are redeemed and credit enhancement builds up. The agency's expected downturn is likely to cause Funding 2 reserve fund draws to the extent that the credit enhancement available to the 'BBB' rated notes is reduced beyond the level required to maintain a 'BBB' rating, necessitating the Negative Outlook, which has been placed on these notes. Fitch will continue to monitor the performance of Granite closely and take appropriate rating action should defaults be tracked to its expectations. The agency has affirmed the ratings on the notes issued from Funding 2 assigned a rating of 'A', 'AA' and 'AAA'.

Whinstone

Whinstone, issued in November 2005, is a fully funded synthetic securitisation which, at closing, referenced the performance of the reserve funds acting as credit enhancement for three standalone, pass-through transactions (Granite 99-1, Granite 00-1 and Granite 00-2) as well as the 10 capitalist issuances from the Funding platform of Granite. This synthetic securitisation enabled NR to purchase credit protection via a credit default swap from the issuer against the referenced reserve funds. Should losses exceed the threshold amount, a credit protection

payment will be made to NR and the Whinstone notes will be written down by a corresponding amount.

Credit enhancement for the notes issued by Whinstone is provided by subordinated notes and the threshold amount equal to the Funding reserve fund, which is defined as 1% of the aggregate outstanding balance of the notes of all the Funding issuers. Credit enhancement is calculated as the threshold amount expressed as a percentage of: (i) the total funding share in the Granite programme; plus (ii) the balance of the three standalone transactions. As the standalone transactions subsequently redeemed, the credit enhancement built up. This factor, in concert with historically good asset performance, led to an upgrade of the 'BBB' and 'BB' notes issued by Whinstone to 'BBB+' and 'BB+', respectively, in January 2007. In November 2008, the reserve funds providing credit enhancement for Granite Mortgages 04-2 plc and Granite Mortgages 04-3 plc were required to be increased following the occurrence of an arrears step-up trigger event whereby the balance of loans more than three months in arrears exceeded the 2% threshold. These stepped-up amounts increase the threshold amount and result in additional support for the Whinstone transaction to the extent that the required increase is met by the trapping of excess spread.

Although credit enhancement has built up, it is not yet at a level able to prevent rating migration in the event of the aforementioned housing market deterioration. Moreover, the speed at which future credit enhancement for the 'BBB+' tranches accrues will be decreased in the event of any deceleration in the Granite prepayment rate. In this scenario, Fitch expect the Funding reserve fund to be utilised to the extent that credit enhancement available to the Whinstone notes is no longer sufficient to preserve their existing 'BB+' and 'BBB+' ratings and following further investigation, the three 'BB+' notes have been downgraded to 'BB-' and placed on Negative Outlook whilst the three 'BBB+' notes have been downgraded to 'BBB' and placed on Negative Outlook.

Whinstone 2

Whinstone 2 is a fully funded synthetic securitisation referencing the performance of the Funding 2 reserve fund and the GMI reserve fund. At closing of Whinstone 2, these reserve funds acted as credit enhancement for the first six series (Series 2005-1, Series 2005-2, Series 2005-3, Series 2005-4, Series 2006-1, Series 2006-2) issued by GMI under the Granite programme. A credit protection payment will be made to NR to the extent that losses exceed the threshold amount and the Whinstone 2 notes will be written down by an equivalent amount.

Credit enhancement for the notes issued by Whinstone 2 is provided by a static threshold amount of GBP101m. Credit enhancement is calculated as the threshold amount as a percentage of the total outstanding balance of the referenced GMI notes. Consequently, as the notes issued by the GMI referenced transactions have redeemed, credit enhancement has increased, however, the speed at which future credit enhancement accrues will be decreased in the event of any deceleration in the Granite prepayment rate. In November 2008, the Funding 2 reserve fund providing credit enhancement for notes issued by GMI increased following the occurrence of an arrears step-up trigger event whereby the balance of loans more than three months in arrears exceeded the 2% threshold. These stepped-up amounts provide additional support for Whinstone 2 to the extent that the increase in the aforementioned reserve fund is met by the trapping of excess spread. Nevertheless, the accumulated credit enhancement is insufficient to prevent rating migration in this analysis and further analysis warranted the downgrade of the two 'BB' notes to 'BB-' whilst the Outlook was placed on Negative.

Aire Valley

Credit performance of the underlying mortgage collateral of the Aire Valley trust has deteriorated significantly during 2008 exacerbated by the non-conforming

nature of the collateral, which exposes this transaction to higher defaults and loss severities. As at January 2009, approximately 77% of the Aire Valley pool comprised BTL loans, whilst the remaining 23% of the pool were owner-occupied mortgage loans to borrowers who had self-certified their income. Similarly, the rating action with respect to the 'BBB' notes issued by the Lanark programme reflects the characteristics of the assets backing the trust. At the date of last investor report in November 2008, BTL loans accounted for approximately 34% of the Lanark pool. Fitch's analysis shows that BTL loans have a higher than average geographical concentration and relatively higher exposure to new-build flats. Moreover, a large number of BTL investors invest for capital gains in expectation of house price increases. Any house price correction could tempt a large number of these investors in similar areas with comparable properties to exit the market concurrently, thereby intensifying house price declines.

Exacerbating the agency's negative outlook with respect to Aire Valley, is the high proportion of self-certified borrowers who are inherently more susceptible to default as demonstrated by the relatively worse performance of these loans to date and the rate at which their performance is deteriorating in comparison to prime conforming residential mortgages. Aire Valley's higher than average exposure to high LTV mortgages is a further source of downside risk to performance, specifically as these borrowers are particularly exposed to house price declines, potentially leaving them in a position of negative equity with the effect of increasing losses in the event of repossession. Fitch expects a continuation of the recent trend of negative house price adjustments and, as such, would anticipate the proportion of loans with a high current LTV to increase, all other things remaining equal.

Aire Valley currently fails to meet each of the replenishment conditions necessary to permit substitution. Consequently, future performance is likely to be further jeopardised given that the assignment of new loans to the pool has the effect of attenuating arrears.

The transaction has experienced a substantial decline in the prepayment rate over the past 12 months, emphasising the difficulty that these borrowers are having refinancing following the widespread tightening of underwriting criteria and, in some cases, the complete withdrawal of these mortgages from several lenders' product ranges. It has been reported that available BTL products have declined by almost 85% since early 2008. Although the sharp reduction in the prepayment rate reduces the speed at which the trust size declines and hence a non-asset trigger is breached, it will have the effect of slowing the rate at which credit enhancement can amass and may cause certain classes of notes to be repaid less rapidly than expected, which could result in certain notes extending past their step-up dates in the absence of being refinanced.

In the event of the agency's anticipated downturn, the lower rated tranches issued through Aire Valley are susceptible to negative rating migration. This factor in combination with the sharp deterioration in the underlying collateral performance and non-conforming nature of the assets, necessitates the Negative Outlook placed on the outstanding 'BB' and 'BBB' tranches. Fitch will continue to monitor the performance of Aire Valley closely and take appropriate rating action should defaults be tracked to its expectations. The agency has affirmed the ratings of the notes assigned a rating of 'AA' and 'AAA'.

Rating Affirmation

The ratings of all notes in the following nine master trust programmes are expected to remain Stable and have therefore been affirmed - Arkle, Fosse, Gracechurch, Holmes, Langton, Mound, Pendeford, Permanent and Silverstone.

Credit enhancement levels within some of the more seasoned programmes that have seen no recent issuance have increased over time following the partial or full principal redemption of the respective notes, historically sound collateral

performance and the non-amortising nature of the reserve funds. Some of the programmes which have issued notes more recently have been structured with substantial first-loss buffers accomplished by inflated reserve funds or in the utilisation of deeply subordinated notes.

Although these transactions have not been highlighted as at-risk, Fitch will continue to monitor these programmes on a regular basis and as performance warrants, taking rating action as appropriate to ensure that the assigned ratings remain accurate.

















Appendix 1: Rating Action


Tranches Placed on Negative Outlook


Transaction	Tranche	Current rating	Revised rating
Aire Valley Mortgages 2004-1 Plc	Series 3 Class D1	BB ⊕	BB ⊖
Aire Valley Mortgages 2004-1 Plc	Series 3 Class D2	BB ⊕	BB ⊖
Aire Valley Mortgages 2008-1 Plc	Series 2 Class D	BB ⊕	BB ⊖
Aire Valley Mortgages 2004-1 Plc	Series 3 Class C1	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2004-1 Plc	Series 3 Class C2	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2005-1 Plc	Series 2 Class C2	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2006-1 Plc	Series 1 Class C2	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2006-1 Plc	Series 2 Class C2	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2007-1 Plc	Series 1 Class C	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2007-1 Plc	Series 2 Class C	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2007-2 Plc	Class C	BBB ⊕	BBB ⊖
Aire Valley Mortgages 2008-1 Plc	Series 2 Class C	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2005-1	Class C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2005-1	Class C3	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2005-2	Class C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2005-4	Class C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2005-4	Class C3	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2005-4	Class C4	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-1	Class C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-1	Class C3	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-1	Class C4	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-2	Class C1	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-2	Class C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-2	Class C3	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-3	Class C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-3	Class C3	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-4	Class C1	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-4	Class C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2006-4	Class C3	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-1	Class 1C1	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-1	Class 2C1	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-1	Class 2C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-1	Class 3C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-1	Class 3C1	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-2	Class 2C1	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-2	Class 2C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-2	Class 3C2	BBB ⊕	BBB ⊖
Granite Master Issuer Plc - Series 2007-2	Class 3C3	BBB ⊕	BBB ⊖
Lanark Master Issuer Plc Series 2007-1	Series 4 Class D2	BBB ⊕	BBB ⊖
Lanark Master Issuer Plc Series 2007-1	Series 4 Class D3	BBB ⊕	BBB ⊖
Paragon Mortgages (No. 14) plc	Class C1a	A ⊕	A ⊖
Paragon Mortgages (No. 14) plc	Class C1b	A ⊕	A ⊖
Paragon Mortgages (No. 15) plc	Class C1b	A ⊕	A ⊖


⊕ Rating outlook positive
 ⊙ Rating outlook stable
 ⊖ Rating outlook negative
 Source: Fitch

Tranches Downgraded

Transaction	Tranche	Current rating	Revised rating
Whinstone Capital Management Limited	Class B1	BBB+ 	BBB 
Whinstone Capital Management Limited	Class B2	BBB+ 	BBB 
Whinstone Capital Management Limited	Class B3	BBB+ 	BBB 
Whinstone Capital Management Limited	Class C1	BB+ 	BB- 
Whinstone Capital Management Limited	Class C2	BB+ 	BB- 
Whinstone Capital Management Limited	Class C3	BB+ 	BB- 
Whinstone 2 Capital Management Limited	Class C1	BB 	BB- 
Whinstone 2 Capital Management Limited	Class C2	BB 	BB- 

 Rating outlook positive

 Rating outlook stable

 Rating outlook negative

Source: Fitch

Appendix 2: Loss Coverage by Vintage for UK Pass-Through Transactions

2007 Vintage

Expected Case

WA Expected defaults ^a (%)	8.8
WA Expected loss severity ^a (%)	24.1
WA Loss required to cause 'AAA' default (%)	13.7
Current 'AAA' loss coverage ^a (x)	6.5

^a Fitch expectation for a 30% peak to trough house price decline
Source: Fitch

'AAA' Loss Coverage - 2007 Vintage

Default rates (x)	Peak to trough house price decline								
	30	35	40	45	50	55	60	65	70
6	9.5	7.9	6.7	5.9	5.2	4.7	4.2	3.9	3.6
8	7.1	5.9	5.0	4.4	3.9	3.5	3.2	2.9	2.7
10	5.7	4.7	4.0	3.5	3.1	2.8	2.5	2.3	2.1
12	4.7	3.9	3.4	2.9	2.6	2.3	2.1	1.9	1.8
15	3.8	3.1	2.7	2.3	2.1	1.9	1.7	1.5	1.4
20	2.8	2.4	2.0	1.8	1.6	1.4	1.3	1.2	1.1
25	2.3	1.9	1.6	1.4	1.2	1.1	1.0	0.9	0.9
30	1.9	1.6	1.3	1.2	1.0	0.9	0.8	0.8	0.7

Source: Fitch

2006 Vintage

Expected Case

WA expected defaults ^a (%)	6.4
WA expected loss severity ^a (%)	18.0
WA loss required to cause 'AAA' default (%)	16.6
Current 'AAA' loss coverage ^a (x)	14.4

^a Fitch expectation for a 30% peak to trough house price decline
Source: Fitch

'AAA' Loss Coverage - 2006 Vintage

Default rates (x)	Peak to trough house price decline								
	30	35	40	45	50	55	60	65	70
6	15.4	12.0	9.9	8.4	7.3	6.4	5.8	5.2	4.8
8	11.5	9.0	7.4	6.3	5.5	4.8	4.3	3.9	3.6
10	9.2	7.2	5.9	5.0	4.4	3.9	3.5	3.1	2.9
12	7.7	6.0	4.9	4.2	3.6	3.2	2.9	2.6	2.4
15	6.1	4.8	3.9	3.3	2.9	2.6	2.3	2.1	1.9
20	4.6	3.6	3.0	2.5	2.2	1.9	1.7	1.6	1.4
25	3.7	2.9	2.4	2.0	1.7	1.5	1.4	1.3	1.1
30	3.1	2.4	2.0	1.7	1.5	1.3	1.2	1.0	1.0

Source: Fitch

2005 Vintage

Expected Case

WA Expected defaults ^a (%)	5.0
WA Expected loss severity ^a (%)	13.8
WA Loss required to cause 'AAA' default (%)	19.4
Current 'AAA' loss coverage ^a (x)	28.1

^a Fitch expectation for a 30% peak to trough house price decline
Source: Fitch

'AAA' Loss Coverage - 2005 Vintage

Default rates (x)	Peak to trough house price decline								
	30	35	40	45	50	55	60	65	70
6	23.4	17.2	13.6	11.2	9.6	8.3	7.4	6.6	6.0
8	17.6	12.9	10.2	8.4	7.2	6.3	5.5	5.0	4.5
10	14.1	10.3	8.2	6.7	5.7	5.0	4.4	4.0	3.6
12	11.7	8.6	6.8	5.6	4.8	4.2	3.7	3.3	3.0
15	9.4	6.9	5.4	4.5	3.8	3.3	3.0	2.7	2.4
20	7.0	5.2	4.1	3.4	2.9	2.5	2.2	2.0	1.8
25	5.6	4.1	3.3	2.7	2.3	2.0	1.8	1.6	1.4
30	4.7	3.4	2.7	2.2	1.9	1.7	1.5	1.3	1.2

Source: Fitch

Pre-2005 Vintage

Expected Case

WA Expected defaults ^a (%)	5.6
WA Expected loss severity ^a (%)	7.6
WA Loss required to cause 'AAA' default (%)	30.6
Current 'AAA' loss coverage ^a (x)	> 50

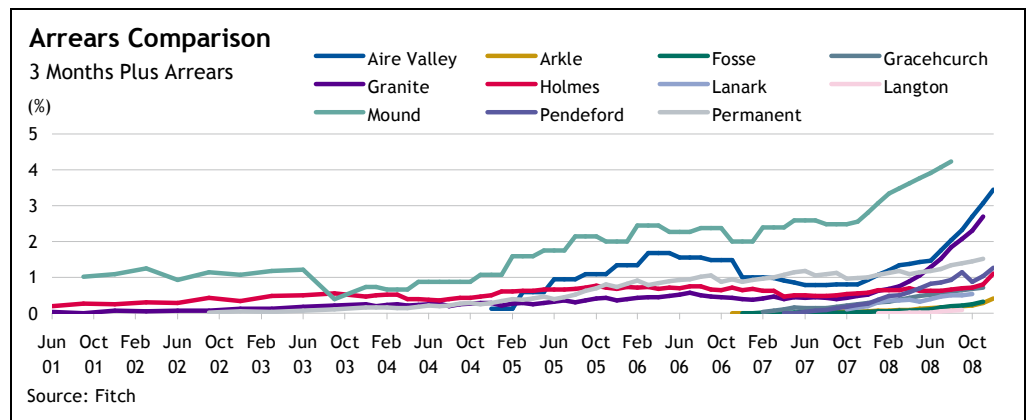
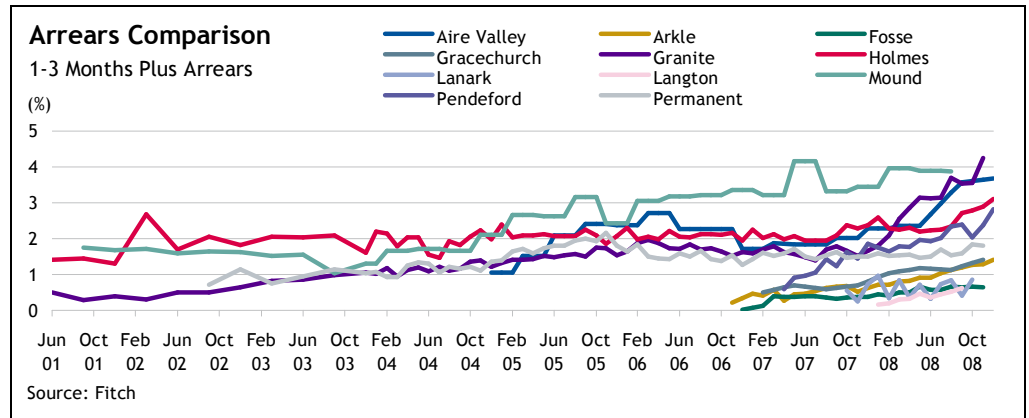
^a Fitch expectation for a 30% peak to trough house price decline
Source: Fitch

'AAA' Loss Coverage - Pre-2005 Vintage

Default rates (x)	Peak to trough house price decline								
	30	35	40	45	50	55	60	65	70
6	> 50.0	40.4	28.9	22.6	18.5	15.6	13.6	12.0	10.7
8	> 50.0	30.3	21.7	16.9	13.9	11.7	10.2	9.0	8.0
10	40.1	24.2	17.4	13.5	11.1	9.4	8.1	7.2	6.4
12	33.5	20.2	14.5	11.3	9.2	7.8	6.8	6.0	5.4
15	26.8	16.2	11.6	9.0	7.4	6.3	5.4	4.8	4.3
20	20.1	12.1	8.7	6.8	5.5	4.7	4.1	3.6	3.2
25	16.1	9.7	6.9	5.4	4.4	3.8	3.3	2.9	2.6
30	13.4	8.1	5.8	4.5	3.7	3.1	2.7	2.4	2.1

Source: Fitch

Appendix 3: Master Trust Performance



Appendix 4

Master Trust Comparison Table

Issue	Aire Valley 2008-1 Jul 2008	Arkle 2008-2 Aug 2008	Fosse 2008-1 Oct 2010	Gracechurch 2007-1 May 2007	Granite 2007-3 Jun 2006	Holmes 2008-2 Dec 2008	Lanark 2007-1 Sep 2007	Langton 2008-3 May 2008	Mound 6 Nov 2008	Pendeford 2008-2 Oct 2008	Permanent 2008-2 May 2008	Silverstone 2008-2 Dec 2008
Closing CE (%)												
AAA	16.1	11.0	9.2	10.2	12.2	8.8	10.4	9.6	16.3	18.5	8.0	11.0
AA	12.2	7.4	6.1	7.2	8.9	5.9	6.6	-	15.0	17.6	4.8	-
A	-	5.0	3.6	4.6	5.5	4.8	4.8	-	-	-	-	-
BBB	5.9	1.7	1.8	1.3	1.7	2.3	1.5	-	13.0	16.8	1.7	-
BB	3.6	-	-	-	-	1.8	-	-	-	-	-	-
Reserve fund	3.6	1.5	1.8	1.3	1.7	1.8	1.5	1.0	13.0	15.4	1.7	1.7
Loan-to-Value (%)												
WAOLTV	81.7	75.2	69.1	62.7	79.3	69.4	67.5	66.2	72.7	78.9	62.0	66.1
>80 OLTV	73.1	49.0	34.9	21.5	61.0	36.6	26.1	33.8	42.1	63.3	21.0	31.5
WACLTV	81.1	70.4	61.3	56.6	74.8	61.2	64.0	65.8	68.9	79.0	60.3	61.1
>80 CLTV	46.1	27.9	16.5	15.2	58.2	30.0	11.7	28.6	31.4	57.7	17.9	23.1
WACLTV (Indexed)	76.0	63.5	57.8	55.7	71.8	62.5	61.0	63.1	69.4	79.5	57.5	62.0
Mortgage Characteristics (%)												
Buy-to Let	76.7	0.0	0.0	0.0	0.0	0.0	31.6	0.0	14.9	59.1	0.0	0.0
Self-Cert	22.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	43.9	28.1	0.0	0.0
IO	86.8	44.2	42.2	38.7	40.5	52.5	42.6	39.8	69.8	83.3	39.8	27.5
Flexible loans (%)	100.0	100.0	40.0	99.1	98.0	12.9	100.0	37.1	29.8	11.6	0.4	100.0
Remortgages (%)	42.1	41.5	52.1	0.0	0.0	56.9	47.8	41.0	52.0	38.6	35.6	43.1
WA Seasoning (Months)	38.5	43.1	52.2	19.5	23.3	36.2	17.8	29.8	40.2	29.5	40.6	38.8
Borrower Characteristics (%)												
<3 months arrears	3.5	0.9	0.6	2.3	1.3	3.6	1.3	0.1	3.9	1.4	3.1	0.1
>3 months arrears	1.5	0.2	0.1	0.1	0.3	0.5	0.2	0.0	2.7	0.7	1.1	0.0
WA DTI	35.1	39.2	35.7	50.1	33.4	41.0	35.3	37.3	35.6	36.8	34.2	35.0
WA Income Multiple	2.8	3.1	3.0	4.0	3.2	3.8	2.8	3.2	2.6	2.8	2.7	2.9
WA ICR for BTL Loans	111.0	0.0	0.0	0.0	0.0	0.0	126.6	0.0	107.8	109.0	0.0	0.0
% London / OM / SE	55.7	43.8	34.9	50.9	41.0	54.6	32.7	37.4	74.7	51.8	42.0	43.1

Source: Fitch

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