S&P Global Ratings

Research

New Issue: Harbour No.2 PLC

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New Issue: Harbour No.2 PLC

Ratings Detail

Transaction profile	
Issuer	Harbour No.2 PLC
Collateral type	RMBS non-conforming
Domicile of assets	U.K.
Seller	Ise of Wight Home Loans Ltd.
Servicers	Topaz Finance Ltd., Intrum Mortgages UK Finance Ltd., and Pepper (UK) Ltd.
Counterparty	Barclays Bank PLC

Capital structure

Class	Rating	Class size (%)	Credit enhancement (%)	Coupon (%)	Step-up coupon (%)	Step-up date	Legal final maturity
A1	AA (sf)	64.08	33.80	SONIA + a margin	SONIA + a margin	October 2027	January 2054
A2	AA (sf)	3.37	33.80	SONIA + a margin	SONIA + a margin	October 2027	January 2054
B-Dfrd*	A (sf)	7.40	26.40	SONIA + a margin	SONIA + a margin	October 2027	January 2054
C-Dfrd*	BBB (sf)	6.95	19.45	SONIA + a margin	SONIA + a margin	October 2027	January 2054
D-Dfrd*	B- (sf)	5.10	14.35	SONIA + a margin	SONIA + a margin	October 2027	January 2054
E-Dfrd*	CCC+ (sf)	3.20	11.15	SONIA + a margin	SONIA + a margin	October 2027	January 2054
F-Dfrd*	CCC (sf)	4.15	7.00	SONIA + a margin	SONIA + a margin	October 2027	January 2054
Z	NR	5.75	N/A	N/A	N/A	N/A	January 2054
R	NR	1.59	N/A	N/A	N/A	N/A	January 2054
X-Dfrd	CCC (sf)	1.50	N/A	SONIA + a margin	SONIA + a margin	October 2027	January 2054
X1 Certificates	NR	N/A	N/A	N/A	N/A	N/A	January 2054
X2 Certificates	NR	N/A	N/A	N/A	N/A	N/A	January 2054
Y Certificates	NR	N/A	N/A	N/A	N/A	N/A	January 2054

*Our rating on this class considers the potential deferral of interest payments. SONIA--Sterling Overnight Index Average. NR--Not rated. N/A--Not applicable.

The Credit Story

The portfolio for Harbour No.2 PLC contains £366 million first-lien residential mortgage loans located in the U.K. The portfolio is a refinancing of Harbour No.1 PLC which we rate and contains three distinct subpools: MORAG, serviced by Topaz Finance Ltd., accounts for 29% of the portfolio; WALL, serviced by Intrum Mortgages UK Finance Ltd., accounts for 31%; and MAQ, serviced by Pepper (UK) Ltd., accounts for 40%. The pool comprises 5.9% buy-to-let

(BTL) loans and 94.1% owner-occupied properties.

Credit strengths

Key factor	Description
Seasoning	The pool is well-seasoned, with a weighted-average seasoning of over 17 years (including performing/reperforming and loans in arrears). In our view, more-seasoned performing loans exhibit lower risk profiles than less-seasoned loans.
Liquidity coverage	The transaction features a nonamortizing general reserve, which was fully funded at closing and provides credit enhancement and liquidity for the collateralized notes to meet revenue shortfalls. The transaction can also use principal receipts to pay senior fees and interest on the notes (subject to various conditions). The transaction also features an amortizing liquidity reserve fund to provide liquidity to the class A1 and A2 notes and to pay senior fees and X1 and X2 certificates.
Sequential payment	The application of principal proceeds is fully sequential. Credit enhancement can therefore build up over time for the rated notes, enabling the capital structure to withstand performance shocks.
PDL establishment	Any losses on the portfolio and any use of principal as available revenue receipts would result in the issuer recording an amount in the principal deficiency ledger (PDL). This will provide additional protection to the notes, as excess spread can be used to pay down the notes.

Credit concerns

Key factor	Description	Mitigant
Borrower characteristics	Of the final portfolio, some borrowers have previously been subject to a county court judgment (CCJ; 6.0%), an individual voluntary arrangement, or a bankruptcy order (3.8%) prior to the origination, or may be self-employed (50.2%), have self-certified their incomes (29.9%), or were otherwise considered by banks and building societies to be nonconforming borrowers. We consider such loans to be more likely to exhibit a higher historical default probability than otherwise-similar loans.	We have increased our weighted-average foreclosure frequency (WAFF) estimates to address this risk. Other negative credit characteristics--such as borrowers with a high loan-to-income (61.1% of borrowers with a multiple above 3.25x), or a high proportion of cash out loans (57.9%), BTL loans without available rental information (5.9%), or commercial properties (0.3%)--have also been accounted for and reflected in our WAFF estimates.
Arrears trend	Of the final pool, 55.4% comprises loans in arrears, including 44.3% in over 90 days' delinquency. Arrears have been rising since late 2022 due to the cost of living crisis and the rising interest rate environment. The current arrears level is considerably above our pre-2014 nonconforming index.	We have increased our WAFF adjustments to address this risk and apply 100% WAFF on loans in severe arrears.
Interest-only loan maturity date concentration	82.9% of the pool comprises interest-only (IO) and part and part loans maturing between 2024 and 2047 while 4.5% of the pool is comprised of IO loans past their maturity date. About 25% of the pool is set to reach maturity in 2032, which is reflected in our cash flow model.	We have increased our WAFF adjustments to address this risk and apply 100% WAFF on loans past maturity.
Complex fee structure	The complex fee structure includes standard servicing fees, arrears servicing fees, and redemption fees, and different fee structures are in place across subpools.	We have stressed the fees accordingly in our cash flow assumptions.
Audit results	We received a clean dynamic field audit but not an updated pool full audit report for our analysis, and we have considered the pool audit received in 2021. We received a 99/1 pool audit report for the previous transaction and there are a larger than expected number of errors and missing files. Most of this is because different originators were consolidated into one entity throughout the years and documents could have been lost or databases not synchronized correctly.	We consider the loans' high seasoning as a mitigant to the potential lack of reliability of information provided and risk of non-enforceability, given that the loans have been outstanding for more than 10 years. However, we have adjusted our WAFF assumptions given the errors in the report.
Reperforming loans	The portfolio comprises a significant portion of loans that receive different kinds of performance arrangements and are now reperforming (11.1%).	We have adjusted our WAFF assumptions to account for this credit characteristic.
Hedging	There is no swap to hedge the mismatch between the interest rate paid under certain loans (bank base rate) and the interest rate paid under the notes (daily Sterling Overnight Index Average; SONIA).	We have stressed for basis risk in our analysis. To cover the risk of reduction in standard variable rate we have applied a haircut in our analysis.
Defaulted loans	Of the final portfolio, 1.0% of the loans are currently under a repossession/foreclosure process.	We have increased our WAFF adjustments to address this risk and apply 100% WAFF on defaulted loans.

Credit concerns (cont.)

Key factor	Description	Mitigant
Limited representations and warranties	As the beneficial title seller is a special-purpose entity (SPE), it has limited resources to meet its financial obligations and is not the originator of the mortgages. We consider the seller's responsibility for breaching the package to be weaker than what we normally see in U.K. RMBS transactions.	We have increased our originator adjustment to address this risk.

Origination And Servicing

Originators

The portfolio has been originated by 18 different originators with a concentration no greater than 30%, but predominantly focused on GE Money Ltd., Future Mortgages Ltd., Amber Homeloans Ltd., and GMAC. The originators associated with each subpool can be seen in Table 1.

Table 1

Pool composition

	MORAG (Subpool 1)	WALL (Subpool 2)	MAQ (Subpool 3)
Originator	Amber Homeloans Ltd., North Yorkshire Mortgages Ltd.	Amber Homeloans Ltd., Future Mortgages Ltd., GE Money HF Ltd., GE Money HL Ltd., GE Money SL Ltd., GE Money SM Ltd., GEMHLL, IGroup 2 Ltd., Rooftop Mortgages Ltd., Southern Pacific Mortgage Ltd.	Amber Homeloans Ltd., Associates Capital Corporation PLC, Edeus Mortgage Creators Ltd., Future Mortgages Ltd., Heritable Bank PLC, Mars Capital Finance Ltd. (trading as Magellan Homeloans), Mortgages PLC, Rooftop Mortgages Ltd., Southern Pacific Mortgage Ltd., Victoria Mortgage Funding Ltd., Wave Lending Ltd.
Percentage of pool (%)	29	31	40

Servicers

There are three servicers: Topaz Finance Ltd. (MORAG subpool), Intrum Mortgages UK Finance Ltd. (WALL subpool), and Pepper (UK) Ltd. (MAQ subpool).

Topaz Finance Ltd.

Computershare Ltd. is an Australian global finance company, which has permission from the Financial Conduct Authority (FCA) to administer regulated mortgage contracts in the U.K. via its Computershare Loan Services (HML) (CLS) division. Topaz Finance is a fully-owned subsidiary of CLS. CLS is the U.K.'s leading third-party mortgage administrator, servicing prime, nonconforming, BTL, flexible, and lifetime/reverse mortgages. Our servicer ranking on CLS is ABOVE AVERAGE ("Servicer Evaluation: Computershare Loan Services (HML)", published on Dec. 12, 2023).

Intrum Mortgages UK Finance Ltd.

Intrum Mortgages UK Finance (previously Mars Capital Finance) is a specialized servicer which acquires and services mortgage portfolios of banks and investors such as Pimco, NatWest, Shawbrook Bank, BNP Paribas, and Oaktree. It was founded in 2008, and in 2017, the company was purchased by Arrow Global, a large European asset manager in the nonperforming mortgage space.

Pepper (UK) Ltd.

Pepper Money Ltd. was incorporated in Australia in August 2000 as a limited-liability company. In November 2017, Pepper Money delisted from the ASX and accepted a takeover bid from an affiliate of global investment firm KKR. Following the takeover, the Pepper group was about 57% owned by the KKR affiliate, with previous shareholders owning the remainder. In March 2021, the Pepper group completed a corporate restructure, which separated the Pepper business in Australia and New Zealand from the rest of the world. In May 2021, Pepper Money listed on the ASX. Pepper (UK) Ltd. operates in the U.K. Our servicer ranking on it is ABOVE AVERAGE (see "Servicer Evaluation: Pepper (UK) Ltd.", published on July 23, 2024).

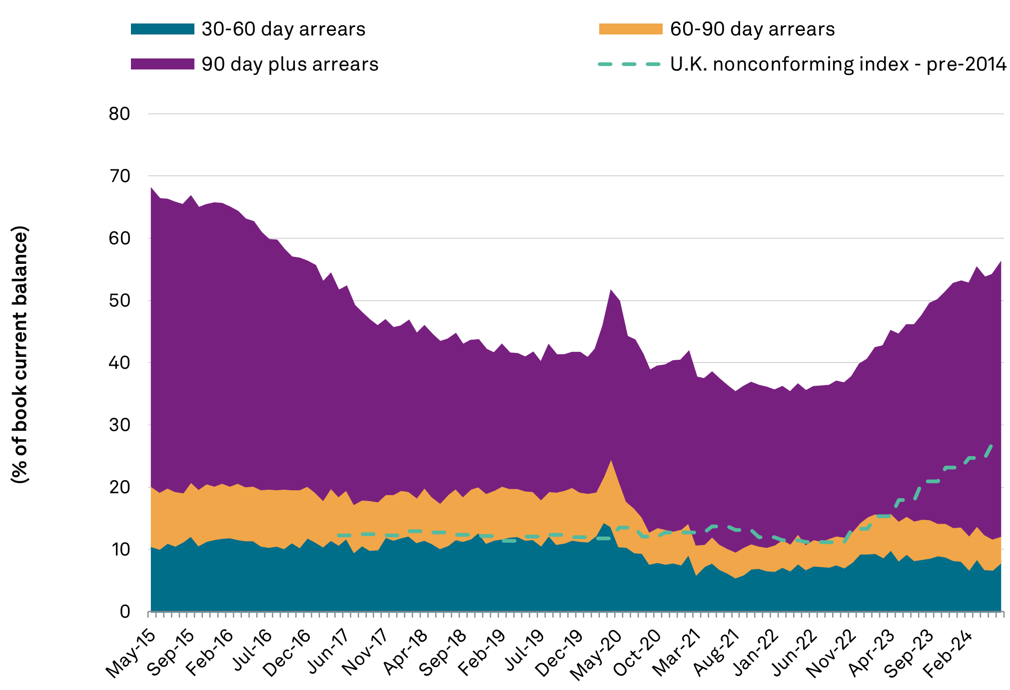
We reviewed the three servicers' processes and are satisfied that they can perform their functions in the transaction. They have an experienced leadership team with good experience in the financial services industry, and we view their compliance and risk management structure as robust. We are comfortable that there are adequate staff levels and supportive information technology systems to continue to effectively service the loans in the pool.

Historical performance

Performance has deteriorated across the portfolio since the end of 2022 due to the rising interest rate environment and cost of living crisis.

Chart 1

Harbour No.2 PLC total arrears



Collateral Characteristics And Peer Comparisons

The pool is well seasoned. The loans are first-lien U.K. owner-occupied and BTL residential mortgage loans. The borrowers in this pool may have previously been subject to a CCJ (or the Scottish equivalent), an individual voluntary arrangement, or a bankruptcy order prior to the origination, and may be self-employed, have self-certified their incomes, or were otherwise considered by banks and building societies to be nonconforming borrowers. The loans are secured on properties in England, Wales, Scotland, and Northern Ireland and were mostly originated between 2002 and 2008.

The transaction is a refinancing of Harbour No.1 PLC, which closed in December 2021.

We received loan-level data as of Sept. 30, 2024, and historical performance data on the originator book since 2015. The quality of data provided is in line with our standards.

We received a clean dynamic field audit but not an updated pool full audit report for our analysis, and we have considered the pool audit received in 2021. We received a 99/1 pool audit report for the previous transaction and there are a larger than expected number of errors and missing files in the audit. We have adjusted our WAFF assumptions to account for this.

Table 2

Collateral characteristics and comparison with previous transaction*

	Harbour No.2 PLC	Harbour No.1 PLC
Jurisdiction	U.K.	U.K.
Originator	See Table 1	See Table 1
Collateral characteristics		
Pool cutoff date	Sept. 30, 2024	Sept. 30, 2021
Principal outstanding of the pool (mil. £))	366	503.9
Number of loans	3,150	4,128
Initial WA interest rate (%)	7.86	2.62
Average loan balance (£)	116,196	122,066
WA indexed current LTV ratio (%)	59.8	62
WA original LTV ratio (%)	84.4	84.5
WA seasoning (months)	215	176
Self-certified borrowers (%)	29.9	28.8
Buy-to-let (%)	5.9	6.3
One or more CCJ (%)	6.0	6.4
Interest only (%)	82.9	80.5
Jumbo valuations (%)	5.9	7.6
Over/under valuation (%)	30.5	36.5
Current arrears greater than or equal to one month (%)	55.4	36.0
Geographic concentration (by balance)		
First	Greater London (20.0%)	Greater London (20.0%)
Second	South East (15.1%)	South East (18.9%)

Table 2

Collateral characteristics and comparison with previous transaction* (cont.)		
Third	North West (14.0%)	North West (14.4%)
Credit assumptions		
Portfolio WAFF (%)		
AAA	74.63	81.39
AA	68.50	71.97
A	64.62	64.74
BBB	60.02	55.56
BB	54.19	43.58
B	52.48	40.54
Portfolio WALS (%)		
AAA	36.05	47.71
AA	29.28	41.04
A	19.07	29.60
BBB	13.61	22.88
BB	10.14	18.29
B	7.46	14.47
Credit coverage (%)		
AAA	26.90	38.83
AA	20.05	29.54
A	12.33	19.17
BBB	8.17	12.71
BB	5.50	7.97
B	3.91	5.87

*Calculations are according to S&P Global Ratings' methodology. LTV--Loan-to-value. CCJ--County court judgment. WA--Weighted-average. WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.

Credit Analysis And Assumptions

The credit analysis of the mortgage portfolio assesses the underlying assets' credit quality, which determines the projected losses under stress conditions commensurate with each rating level. The projected losses are the result of the combination of the loan-level foreclosure frequency (the probability of default) and the loss severity (measuring the loss on the foreclosure amounts).

Table 3

Portfolio WAFF and WALS

Rating level	WAFF (%)	WALS (%)	Credit coverage (%)
AAA	74.63	36.05	26.90
AA	68.50	29.28	20.05
A	64.62	19.07	12.3
BBB	60.02	13.61	8.17
BB	54.19	10.14	5.50

Table 3

Portfolio WAFF and WALS (cont.)

Rating level	WAFF (%)	WALS (%)	Credit coverage (%)
B	52.48	7.46	3.91

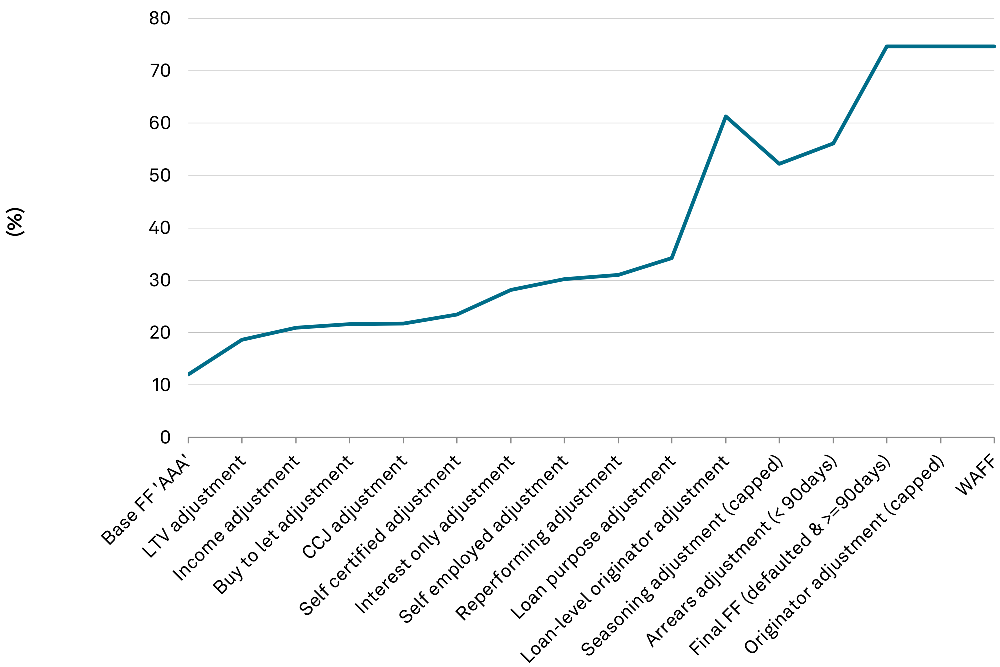
WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.

Foreclosure frequency

Our current 'B' foreclosure frequency assumption for the U.K. archetypal pool is 1.50% and our base 'AAA' foreclosure frequency assumption is 12.0% (see "Sector And Industry Variables Updated For Europe Supplement Of Global RMBS Criteria," published May 17, 2024). Chart 2 and table 4 summarize how the base 'AAA' foreclosure frequency has been adjusted to account for the characteristics of the securitized portfolio.

Chart 2

'AAA' cumulative WAFF distribution



WAFF--Weighted-average foreclosure frequency. FF--Foreclosure frequency. LTV--Loan to value. CCJ--County court judgment.

Table 4

WAFF adjustments

Factor	Description	Adjustment	Cumulative WAFF (%)
Base WAFF	Archetypical pool.	N/A	12.0
LTV ratio	The weighted-average original LTV ratio was 84.4% and the weighted-average current indexed LTV is 59.8%.	1.56x	18.66

Table 4

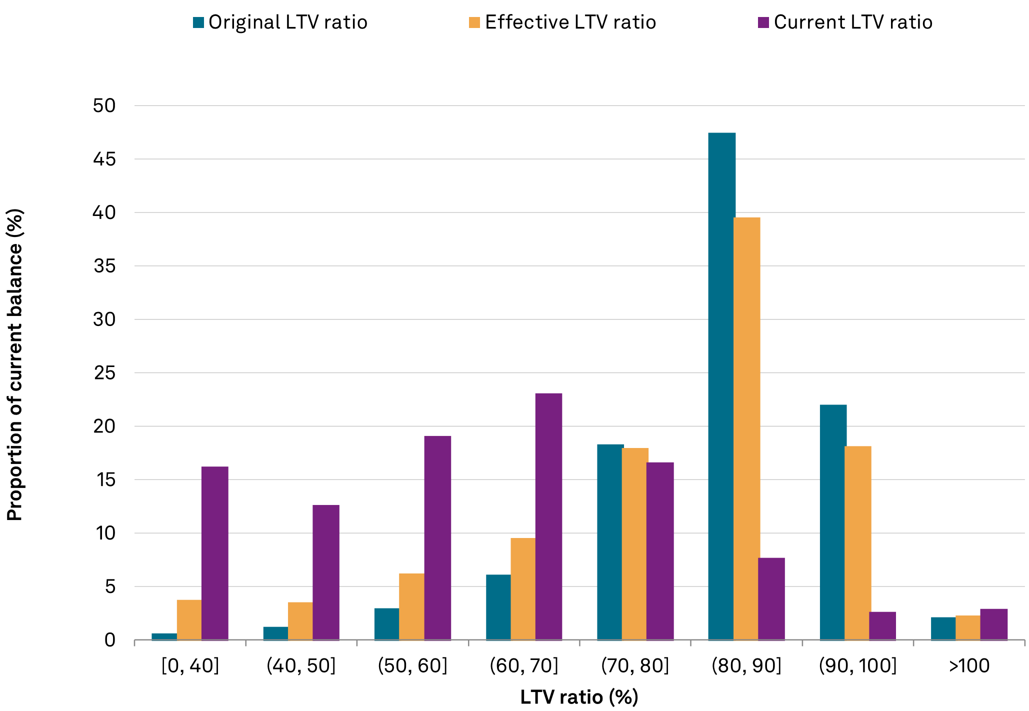
WAFF adjustments (cont.)

Factor	Description	Adjustment	Cumulative WAFF (%)
Income	There is a high proportion of borrowers with a high loan-to-income (61.1%, with a multiple above 3.25x).	1.11x	20.88
Buy-to-let	Approximately 5.9% of the pool comprises BTL loans and the remaining 94.1% are owner-occupier loans. Of these BTL loans, none have rental income information available so receive our highest stress.	1.04x	21.61
CCJ	Of the pool, 6.0% have had prior CCJs. We have reflected this in our analysis by applying an adjustment to the foreclosure frequency.	1.01x	21.70
Self-certified	Of the final pool, 29.9% have self-certified their incomes. We have reflected this in our analysis by applying an adjustment to the foreclosure frequency.	1.09x	23.42
Interest-only	We applied an adjustment for the interest-only loans on owner-occupied properties in the pool.	1.19x	28.17
Self-employed	We applied an adjustment for self-employed borrowers in the pool.	1.07x	30.21
Reperforming	11.1% of loans in the pool are considered reperforming. These are loans which are current and have had in the past three years a type of reperforming arrangement (e.g. arrangement to pay).	1.03x	31.02
Loan purpose	We applied an adjustment for those cases where the borrower increased the loan size when remortgaging (57.9%). The additional leverage might increase the risk of default when compared to a refinance in which no further funds are drawn.	1.12x	34.26
Loan-level originator adjustment	Since a large proportion of the assets in the pool are receiving 100% foreclosure frequency because they are in 90+ days arrears or for other reasons, we believe that applying a pool level originator adjustment would be too conservative and would adjust a significant portion of the portfolio above 100% foreclosure frequency. Additionally, a significant portion of the 90+ days arrears loans have shown active performance with positive payrates. Taking this into account, we apply a loan level originator adjustment.	1.79x	61.32
Seasoning (capped)	The transaction comprises loans originated between 2002 and 2008, with a weighted-average seasoning of over 17 years.	0.87x	52.22
Arrears (<90 days)	The pool comprises 55.4% loans in arrears greater than or equal to one month.	1.28x	56.08
Final foreclosure frequency (defaulted & >=90 days)	90+ days arrears in the pool are currently 44.3%.	100x WAFF for any 90+ days arrears.	74.63
'AAA' WAFF	Actual collateral pool.	N/A	74.63

WAFF--Weighted-average foreclosure frequency. N/A--Not applicable. LTV--Loan-to-value. DSCR--Debt service coverage ratio. CCJ--County court judgment.

Chart 3

Original, effective, and current LTV ratio distribution



LTV--Loan-to-value.

Chart 4

Repayment type distribution

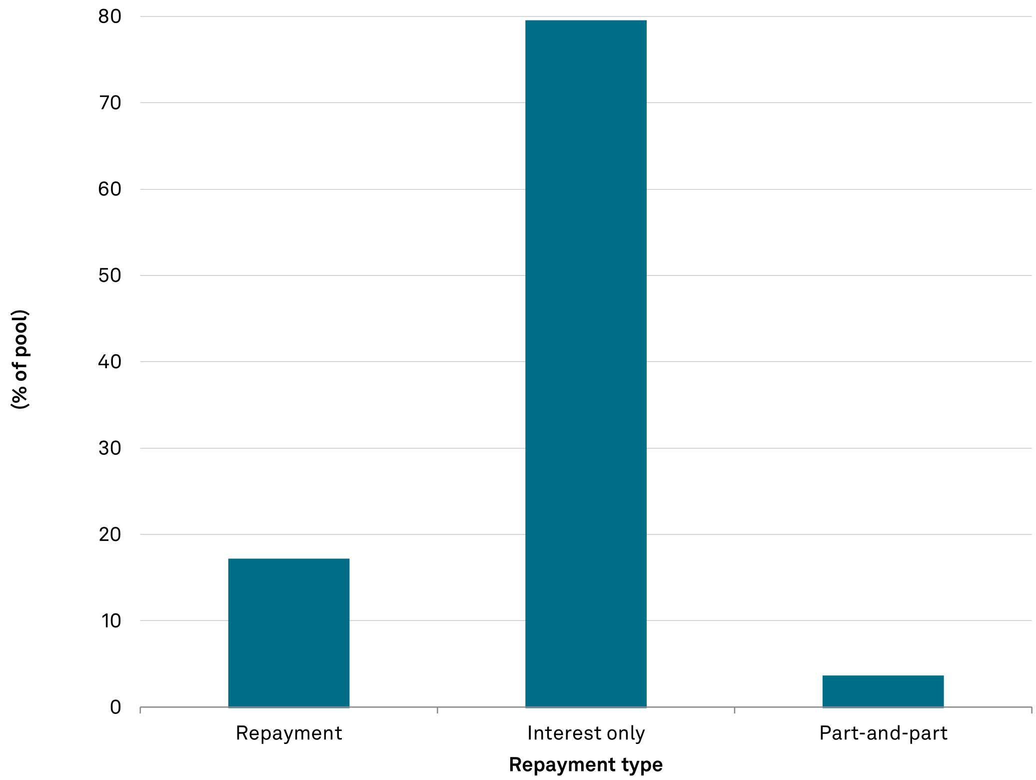
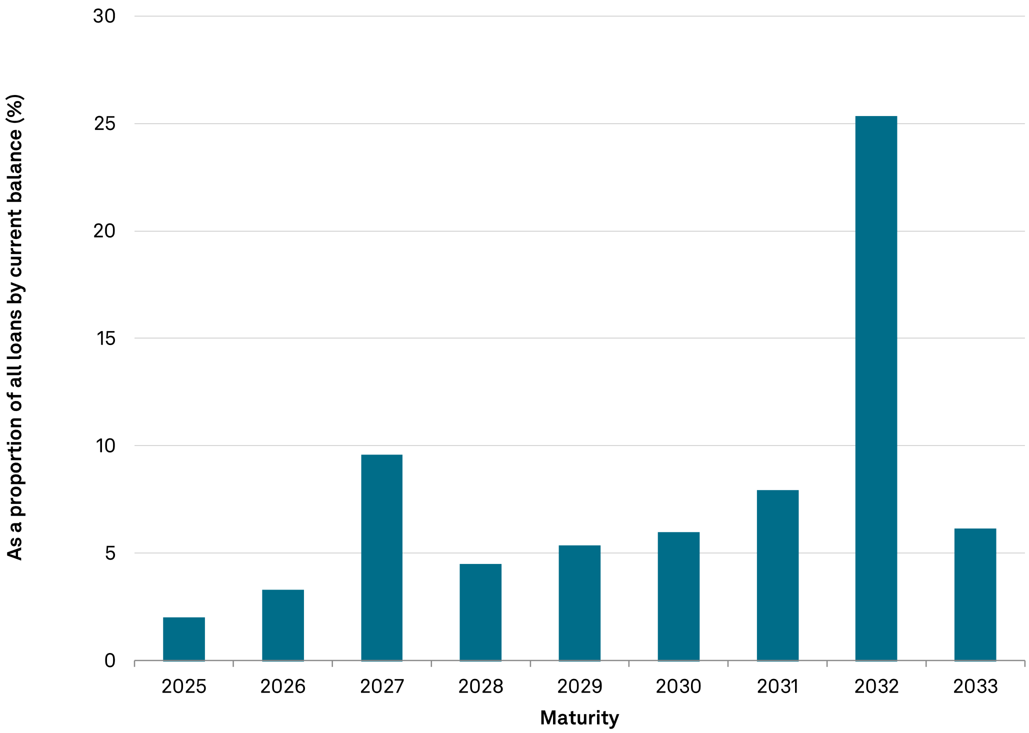


Chart 5

IO loans by maturity year



IO--Interest only.

Table 6

Geographic distribution

Region	Percentage of the pool (%)
London	20.09
Southeast England	15.12
East Anglia	6.17
Southwest England	5.86
Northwest England	14.00
West Midlands	9.19
East Midlands	6.70
Yorkshire and Humberside	8.19
Scotland	3.32
Wales	4.21
Northeast England	4.64
Northern Ireland	2.52

Loss severity

Our base 'B' market value decline (MVD) is 15% and our base 'AAA' MVD is 40% (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019). Table 7 provides details used in the derivation of the stressed repossession MVD (RMVD).

tab7

Table 7

Repossession market value decline (RMVD) adjustments

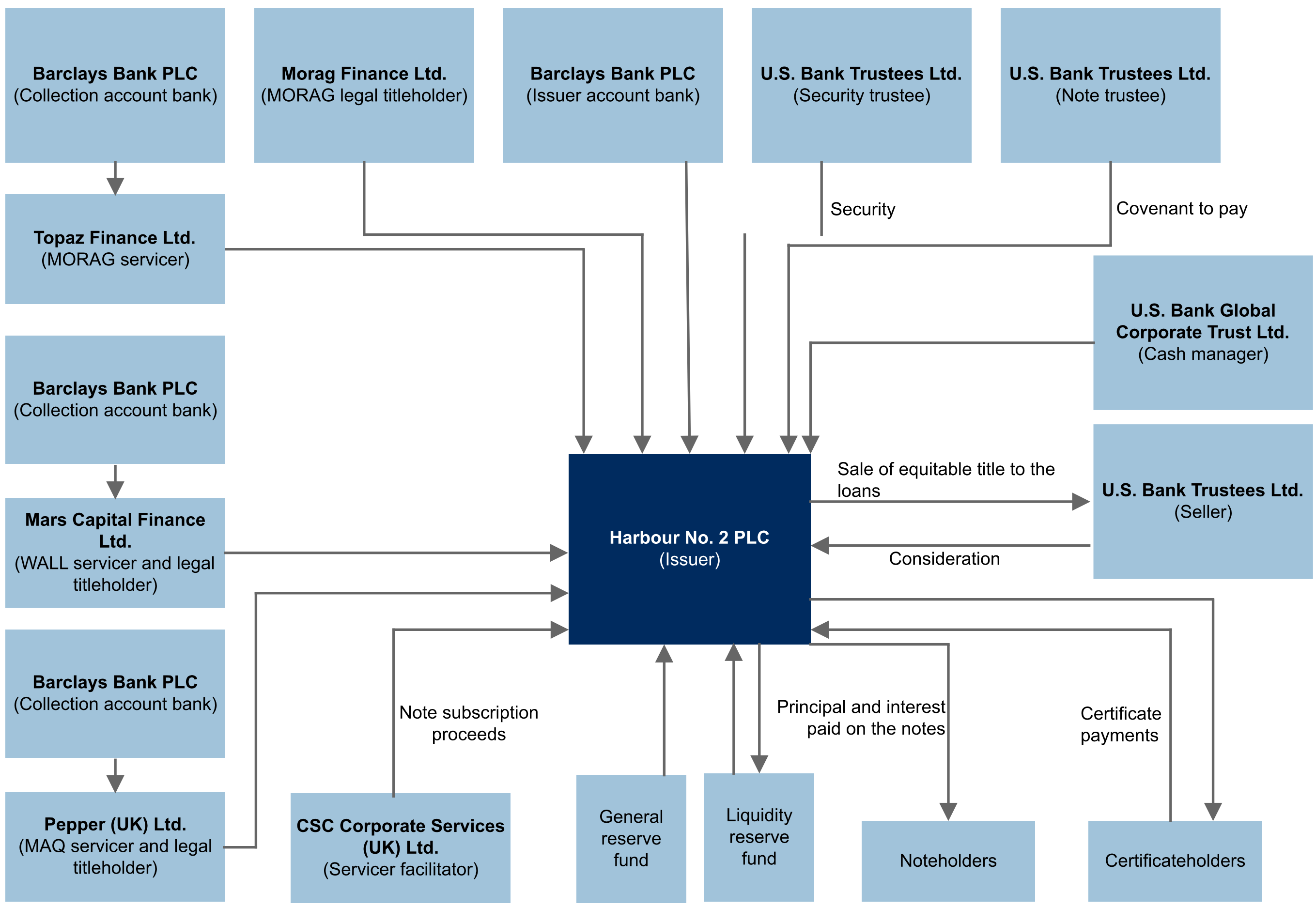
Rating category	Base fixed MVD (%)	Over/undervaluation (%)	Forced sale discount (%)	Jumbo valuations (%)	RMVD (%)*
AAA	40.0	15.27	10.0	59.75	60.12
AA	36.0	13.14	11.0	54.73	55.16
A	28.0	11.00	12.0	46.32	46.78
BBB	23.0	9.16	13.0	40.98	41.44
BB	19.0	7.64	14.0	36.91	37.36
B	15.0	6.11	15.0	32.94	33.39

*RMVD = 1-[1-(Fixed MVD+/-percentage of over/undervaluation x over/undervaluation)] x (1-FSD), plus any additional repossession MVD adjustment factors such as jumbo valuations. MVD--Market value decline. RMVD--Repossession market value decline.

Transaction Structure

Chart 6

Transaction structure



At closing, the issuer purchased the beneficial interest in the portfolio of U.K. residential mortgages from the seller (Isle of Wight Home Loans Ltd.), using the proceeds from the issuance of the notes and certificates.

The issuer is an English SPE, which we consider to be bankruptcy remote. We analyzed its corporate structure in line with our legal criteria.

Interest will be paid quarterly on the interest payment dates, beginning in January 2025. The rated notes pay interest equal to compounded daily SONIA plus a class-specific margin, with a further step-up margin following the optional call date in October 2027. All of the notes will reach legal final maturity in January 2054.

Payment Structure And Cash Flow Mechanics

Collections

All borrowers are instructed to pay directly into the collection account, currently provided by Barclays Bank PLC. Any funds deposited in the collection account will be transferred to the issuer's account with Barclays Bank PLC. Amounts deposited to the issuer's account will be distributed quarterly according to the applicable priority of payments.

Available revenue funds

The issuer's available revenue funds primarily comprise interest collections, recoveries on defaulted loans, the reserve fund, and, if necessary, principal reallocated to cover any interest shortfalls.

Available principal funds

The issuer's available principal funds primarily comprise principal collections and amounts applied to credit PDLs in the interest waterfall.

Pre-enforcement priority of payments

There are separate waterfalls for interest (revenue) and principal collections. On each quarterly payment date, the issuer will apply the available revenue and principal funds in the priority shown in table 8.

Table 8

Priority of payments

Revenue priority of payments	Principal priority of payments
Senior trustee fees and expenses	Principal addition amounts to meet revenue shortfall
Other senior fees and expenses (including capped senior servicing/legal titleholder fees)	Class A* notes principal (until repaid in full)
Amounts due to third parties	Class B-Dfrd notes principal (until repaid in full)
Issuer profit	Class C-Dfrd notes principal (until repaid in full)
Interest on class A* notes, class X1 and class X2 certificates payment	Class D-Dfrd notes principal (until repaid in full)
Top up liquidity reserve fund to required amount	Class E-Dfrd notes principal (until repaid in full)
Class A* PDL	Class F-Dfrd notes principal (until repaid in full)
Interest on class B-Dfrd notes	MSA warranty rebate due and remaining unpaid
Class B-Dfrd notes PDL	Class Z notes principal (until repaid in full)
Interest on class C-Dfrd notes	Class R notes principal (until repaid in full)
Class C-Dfrd notes PDL	All remaining amounts to available revenue receipts
Interest on class D-Dfrd notes	Principal addition amounts to meet revenue shortfall
Class D-Dfrd notes PDL	
Interest on class E-Dfrd notes	
Class E-Dfrd notes PDL	
Interest on class F-Dfrd notes	

Table 8

Priority of payments (cont.)

Revenue priority of payments	Principal priority of payments
Class F-Dfrd notes PDL	
Top up general reserve fund up to required amount	
Class Z notes PDL	
Issuer costs and expenses (including subordinated servicing fees) which remain unpaid following application of available revenue receipts	
Interest on class X-Dfrd notes	
Principal on class X-Dfrd notes (until repaid in full)	
MSA warranty rebate due and remaining unpaid	
Class Y certificate payment	

*Refers to class A1 and A2 notes. PDL--Principal deficiency ledger.

Table 9

Payment structure details

Note terms	
Payment frequency	Quarterly
First interest payment date	January 2025
Interest rate	Compounded daily SONIA plus a class-specific margin.
Optional call	A 10% clean-up call option that is applicable for the class A1, A2, B-Dfrd, C-Dfrd, and D-Dfrd notes. The optional call date is on or after the step-up date.
Step-up date	October 2027
Legal final maturity date	January 2054
General reserve fund	
Initial amount	1.25% of the closing portfolio balance.
Required amount	1.25% of the closing portfolio balance. When the class F-Dfrd notes are redeemed the required amount is zero.
Amortizing	No
Available for	Senior fees and expenses, interest payments on the class A1 to F-Dfrd notes, and amounts on the class A1 to F-Dfrd notes' PDLs if there is a shortfall after applying the interest collections.
Liquidity reserve	
Initial amount	0.5% of the closing class A* notes' balance.
Required amount	The lower of a) 0.50% of the closing class A* notes' balance funded on day one and thereafter and b) 1% of the outstanding class A notes' balance.
Amortizing	Yes
Amortizing conditions	Reduces in line with the class A* notes' current balance.
Available for	Senior fees and expenses and interest payments on the class A* notes and class X1 and X2 certificate payments, if there is a shortfall after applying the interest collections and general reserve fund.
Additional details	The excess will be released to the principal waterfall.
Principal deficiency ledgers	
Number of ledgers	Seven--one for each class of the mortgage-backed notes.

Table 9

Payment structure details (cont.)	
PDL amounts to be recorded	Losses from the portfolio or if the transaction uses principal as available revenue receipts including funding the liquidity reserve.Debits are credited from the most junior subledger upward, while credits are applied from the most senior subledger downward. Any revenue amounts applied to credit the PDL will be applied as available principal funds.

*Refers to class A1 and A2 notes. PDL--Principal deficiency ledger.

Principal to pay interest

In high-delinquency scenarios, there may be liquidity stresses, whereby the issuer would not have sufficient revenue receipts to pay interest due on senior fees or on rated notes. To mitigate this risk the issuer can use any existing principal receipts to pay for any interest shortfall on the class A1 to F-Dfrd notes, subject to various conditions. The use of principal to pay interest would result in the registering of a PDL and may reduce the credit enhancement available to the notes.

Events of default

We view all events of default as ratings remote and therefore do not consider the post-enforcement priority of payments in our analysis. The events of default include, among others, a default in the payment of interest on the most senior notes outstanding or on principal when due.

Early redemption

The notes may be redeemed if the clean-up call option, issuer call option, or tax call option are exercised. Upon exercise of any of these options, the proceeds would need to be sufficient for the issuer to redeem all the outstanding rated notes at par, including any accrued interest.

Cash Flow Modeling Assumptions

We stress the transaction's cash flows to test the credit and liquidity support that the assets, subordinated tranches, and cash reserve provide.

We apply these stresses to the cash flows at all relevant rating levels. In our stresses on the class A1 and A2 notes, all notes must pay ultimate principal and full and timely interest. Our ratings on the class B-Dfrd to F-Dfrd notes address the payment of ultimate principal and interest.

Our cash flow analysis indicates that the available credit enhancement for the class A1 to F-Dfrd notes is commensurate with ratings higher than those currently assigned. However, the ratings on these notes also reflect their ability to withstand the potential repercussions of the cost-of-living crisis, including higher defaults and longer foreclosure timing stresses.

The class X-Dfrd notes did not pass any of the rating scenario stresses, including benign steady state scenarios. However, because our rating on these notes addresses ultimate payment of principal and interest, we believe default is not virtually imminent, as the notes can continue to defer interest until maturity. Under our 'CCC' criteria, we think these notes will require favorable economic conditions for repayment at maturity to occur (see "Related Criteria"). We therefore assigned a 'CCC (sf)' rating.

Interest rate risk

Interest on the notes is equal to daily SONIA plus class-specific margins that step up following the optional redemption date. The underlying collateral is linked to the Bank of England base rate (BBR) or to a standard variable rate (SVR). There is basis risk for the BBR-linked underlying collateral, and the transaction does not benefit from a swap to mitigate this risk. As a result, we stress the historical timing mismatch between the index paid on the assets and that paid on the liabilities.

When modeling the yield on SVR loans (about 8.75%), we considered the servicer's SVR-setting policy (based on BBR or various factors depending on the subpool). We applied haircuts to SVR margins under our criteria for each rating level.

Table 10

Cash flow modeling assumptions

Spread compression	
Applied	Yes, as the asset yield on the pool can decrease if higher-paying assets default or prepay.
Details	We have incorporated this in our cash flow analysis by assuming that the weighted-average yield on the portfolio drops by 0.80% at the 'AAA' rating level.
Fees modelled	
Servicing fee	0.91% which is the higher of 1.5x of the actual fees and 0.40% of the pool balance as per our global RMBS criteria and another two basis points for various fees (including legal title holder and redemption fees). This higher fee is applied to account for the potential increase in costs to attract a replacement servicer.
Fixed fees	£450,000 per year.
One off fees	£215,000 one-off fee.
Commingling risk	
Details	Liquidity stress applied equal to one month of collections, which is returned after four periods.
Setoff risk	
Details	No setoff risk has been modelled as there are no employee loans in the pool and there is no deposit setoff exposure as the seller and legal title holders are not a deposit taking institutions.
Product switches	See "Product switches and further advances".
Further advances	See "Product switches and further advances".

Table 11

Default curves

Front-loaded and back-loaded

Year after closing	Front-loaded defaults (% of WAFF per year)	Back-loaded defaults (% of WAFF per year)
1	25.0	5.0
2	25.0	10.0
3	25.0	10.0
4	10.0	25.0
5	10.0	25.0
6	5.0	25.0

Table 11

Default curves (cont.)

Prepayment assumptions

	High (%)	Low (%)
Pre-recession	30.0	4.0
During recession	3.0	3.0
Post-recession	30.0	4.0

WAFF--Weighted-average foreclosure frequency.

Product switches and further advances

There are no flexible loans, which can overpay and then redraw the overpaid amount in the future. In our view, the risks related to set-off due to redraw are thus non-existent.

Servicers will not honor product switch requests. If such a request is made and agreed the seller is required to repurchase the relevant loan or indemnify the issuer.

A number of loans in the WALL pool are portable but subject to various conditions with regard to leverage.

Default and recovery timings

We used the WAFF and WALS derived in our credit analysis as inputs in our cash flow analysis (see table 3). At each rating level, the WAFF specifies the total balance of the mortgage loans we assume will default over the transaction's life. Defaults are applied on the outstanding balance of the assets as of the closing date. We simulate defaults following two paths (i.e., one front-loaded and one back-loaded) over a six-year period (see table 11). We assume recoveries on the defaulted assets will be received 12 months after default for BTL properties and after 18 months for owner-occupied.

Delinquencies

To simulate the effect of delinquencies on liquidity, we model a proportion of scheduled collections equal to one-third of the WAFF (in addition to assumed foreclosures reflected in the WAFF) to be delayed. We apply this in each of the first 18 months of the recession and assume a full recovery of these delinquencies will occur 36 months after they arise.

Prepayments

To assess the effect on excess spread and the absolute level of defaults in a transaction, we model both high and low prepayment scenarios at all rating levels (see table 11).

Interest rates

We modeled two interest rate scenarios in our analysis: up and down.

Summary

Combined, the default timings, recession timings, interest rates, and prepayment rates described above give rise to eight different scenarios at each rating level (see table 12).

Table 12

RMBS stress scenarios			
Total number of scenarios	**Prepayment rate**	**Interest rate**	**Default timing**
8	High and low	Up and down	Front-loaded and back-loaded

Excess spread

Excess spread is created through the difference between the asset's yield and the issuer's expenses. Table 13 outlines the initial excess spread estimate.

Table 13

Initial excess spread (estimate)	
	Pool (%)
Pool yield	7.94
Senior fees	1.03*
Available for note coupons	6.91
Excess spread remaining after expected coupon payment	
A	2.79
B-Dfrd	2.32
C-Dfrd	1.86
D-Dfrd	1.50
E-Dfrd	1.24
F-Dfrd	0.89
*0.91% senior servicing fee plus £450,000 annual fees.	

Counterparty Risk

The issuer is exposed to Barclays Bank PLC as the transaction account provider and servicers' collection account. The documented replacement mechanisms for the account providers adequately mitigate the transaction's exposure to counterparty risk in line with our counterparty criteria.

Table 14

Supporting ratings				
Institution/role	**Current counterparty rating**	**Minimum eligible counterparty rating**	**Remedy period (calendar days)**	**Maximum supported rating**
Barclays Bank PLC as collection account provider	A+/Stable/A-1	BBB	60	AAA
Barclays Bank PLC as transaction account provider*	A+/Stable/A-1	A	60	AAA

Commingling risk

Borrowers pay into a collection account held with Barclays Bank in the legal titleholders' names. All amounts in the collection account are swept to the transaction account on the next business day.

If the legal titleholders were to become insolvent, mortgage collection amounts in the collection accounts may become part of the legal titleholder's bankruptcy estate. To mitigate this risk, there is a declaration of trust in place over the collection accounts. To address the risk of the collection account bank's insolvency, the transaction documents contain replacement language in line with our counterparty criteria.

Although we believe that the above mechanisms (downgrade language and declaration of trust) mitigate against loss of collections, we have considered that collections could be delayed in the event of an insolvency. In our analysis we have therefore applied a liquidity stress of one month of collections.

Sovereign Risk

Table 15

Details of sovereign risk	
Jurisdiction	U.K.
Long-term unsolicited sovereign credit rating	AA
Rating constrained by sovereign risk criteria	No

Scenario Analysis

In our view, the ability of the borrowers to repay their mortgage loans will be highly correlated to macroeconomic conditions, particularly the unemployment rate, consumer price inflation, and interest rates. Our ratings reflect our current macroeconomic outlook for the U.K., where our forecast for unemployment is 4.4% by the end of 2024 and 4.6% in 2025 and inflation is 2.8% in 2024 and 2.4% in 2025.

Table 16

U.K. housing market statistics

	2023	2024f	2025f	2026f	2027f
Nominal house prices, % change y/y	(1.7)	1.4	2.3	2.6	2.9
Real GDP, % change	0.1	0.6	1.2	1.7	1.7
CPI inflation (%)	7.3	2.8	2.4	2.1	2.0
Unemployment rate	4.0	4.4	4.6	4.4	4.4

Sources: S&P Global Ratings. y/y--Year on year. CPI--Consumer price index. f--Forecast.

Downside scenario

Various factors could lead us to lower our ratings on the notes, such as increasing foreclosure rates in the underlying pool and changes in the pool composition.

We consider the transaction's resilience in case of additional stresses to some key variables, in particular defaults and loss severity, to determine our forward-looking view.

Given our current macroeconomic forecast and our forward-looking view of the U.K.'s housing market, our sensitivity scenarios consider, all else being equal, the hypothetical effect on our credit ratings of different combinations of:

- An increase in WAFF (foreclosure frequency/defaults) by up to 30% at each rating level; and
- An increase in WALS (loss severity) by up to 30% at each rating level.

We therefore ran eight scenarios with increased defaults and higher loss severity, as shown in table 18.

Table 17

Sensitivity analysis

Class	WALS x 1.0	WALS x 1.1	WALS x 1.3
WAFF x 1.0	Base case	Sensitivity 3	Sensitivity 4
WAFF x 1.1	Sensitivity 1	Sensitivity 5	Sensitivity 7
WAFF x 1.3	Sensitivity 2	Sensitivity 6	Sensitivity 8

Class of notes	Initial rating	Scenario 1	2	3	4	5	6	7	8
A1	AA	AA-	AA-	AA-	AA-	AA-	A+	A	A
A2	AA	AA-	AA-	AA-	AA-	AA-	A+	A	A
B-Dfrd	A	A	A-	A	A	A	BBB+	BBB+	BBB
C-Dfrd	BBB	BBB-	BB	BBB	BBB-	BBB-	BB	BB	BB-
D-Dfrd	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below
E-Dfrd	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below
F-Dfrd	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below
X-Dfrd	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below	B- or below

No change

One-notch downgrade

Two-notch downgrade

Three-notch or more downgrade

WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.
Source: S&P Global Ratings.

The results of the above sensitivity analysis indicate a deterioration of no more than one category for the notes, which is in line with the credit stability considerations in our rating definitions.

A general downturn of the housing market may delay recoveries. We have also run extended recovery timings to understand transactions sensitivity to liquidity risk.

The transaction embeds some strengths that may offset deteriorating collateral performance. Given its sequential amortization, credit enhancement is expected to build-up over time. The existence of a general reserve fund and liquidity reserve fund may, to a certain extent, insulate the notes against credit losses and liquidity stresses.

Upside scenario

We could raise the ratings on the class B-Dfrd to F-Dfrd notes if credit enhancement builds as the transaction deleverages, or if the credit quality of the collateral pool improves over time, such as through lower current LTV ratios. Given a large portion of the collateral pool is interest-only, we believe this would largely be due to updated indexed property valuations.

Appendix 1

Table 18

Transaction participants

Role	Participant
Issuer	Harbour No.2 PLC
Holding company	Harbour No.2 Holdings Ltd
Seller	Isle of Wight Home Loans Ltd.
Sponsor and retention holder	Barclays Bank PLC
Arranger and lead manager	Barclays Bank PLC
MORAG legal titleholder	Morag Loans Finance Ltd.
MORAG servicer	Topaz Finance Ltd.
WALL servicer	Intrum Mortgages UK Finance Ltd.
MAQ servicer	Pepper (UK) Ltd.
WALL legal titleholder	Intrum Mortgages UK Finance Ltd.
MAQ legal titleholder	Pepper (UK) Ltd.
Cash manager	US Bank Global Corporate Trust Ltd.
Replacement cash manager facilitator	CSC Capital Markets UK Ltd.
Servicer facilitator	CSC Capital Markets UK Ltd.
Security trustee	US Bank Trustees Ltd.
Note trustee	US Bank Trustees Ltd.
Principal paying agent and registrar	Elavon Financial Services DAC, UK Branch
Corporate services provider	CSC Capital Markets UK Ltd.
Share trustee	CSC Capital Markets UK Ltd.

Related Criteria

- Criteria | Structured Finance | RMBS: Global Methodology And Assumptions: Assessing Pools Of Residential Loans--Europe Supplement, April 4, 2024
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Related Research

- ESG Industry Report Card: Residential Mortgage-Backed Securities, March 31, 2021
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- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016
- European Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016