UK Mortgages Limited

UKML Webinar
Investor Presentation

September 2020

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UK Mortgages Limited

1 Executive Summary

Executive Summary – Fund Recap

- Changes to investment policy and share buyback voted for by shareholders in Aug 2019
- First opportunity to implement new policy and release significant capital expected on Oat Hill 1 refinancing in May-20
  - Delayed due to Covid-19
  - Completed as soon as economically viable in Jul-20
    - Capital release after reserves for existing commitments approx. £30m
    - Intended to be used to fund share buybacks
  - Mortgage and housing markets now re-open
  - RMBS market recovering – with positive supply/demand technical

- Proposed offer made public by M&G Investment Management at 67p on 20th July-20 following a succession of lower offers
  - Proposal declined by UKML board as a material undervaluation
- Extensive board and manager engagement during offer period
  - Further increase to 70p also declined
  - M&G withdraw from proposal
- UKML board to commence strategic review following shareholder consultation

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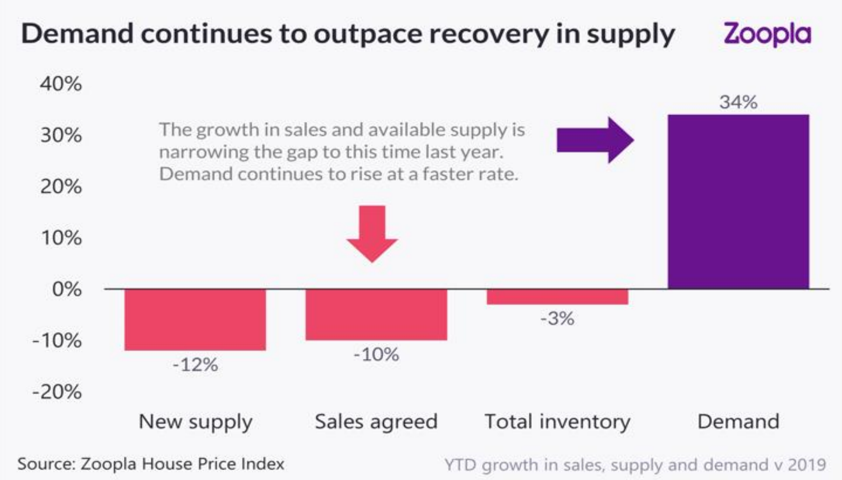
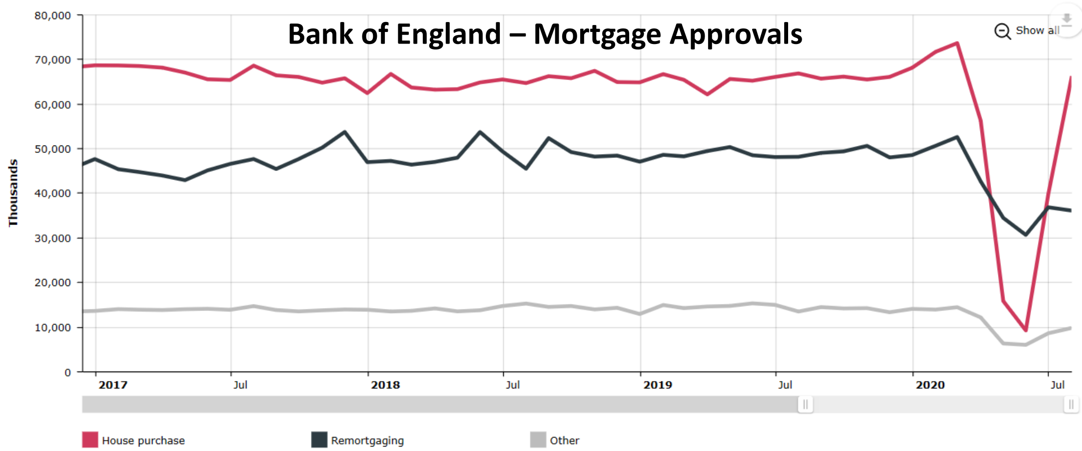
2 Market Update

Mortgage & Housing Markets

- Sharp rebound in housing and mortgage markets – possibly boosted by Stamp Duty cut



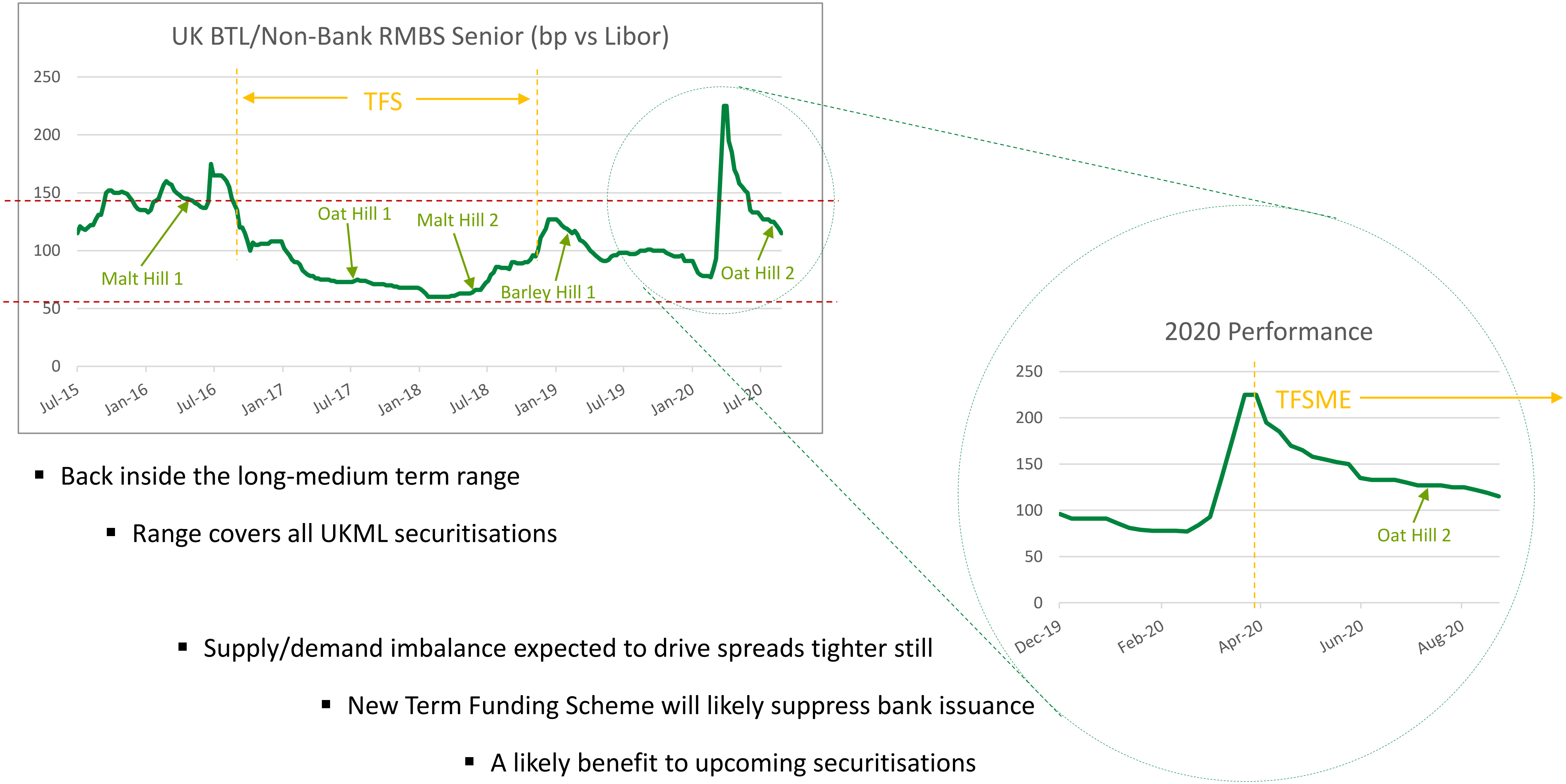


- **A strong positive for borrowers refinancing and improved LTV protection**

Sources: Zoopla, Bank of England, 1-Sep-2020

RMBS & Funding Markets

- RMBS spreads also continue to recover

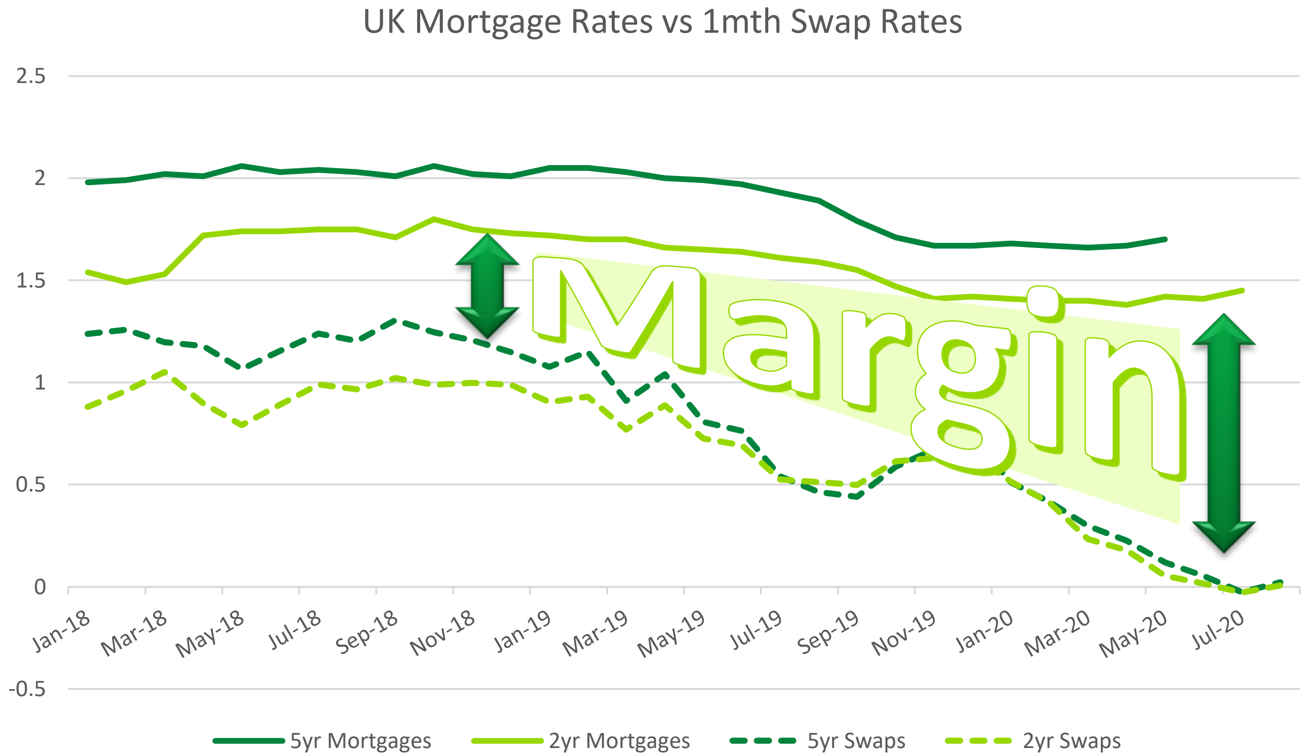


- Back inside the long-medium term range
  - Range covers all UKML securitisations
    - Supply/demand imbalance expected to drive spreads tighter still
      - New Term Funding Scheme will likely suppress bank issuance
        - A likely benefit to upcoming securitisations

Sources: J.P. Morgan, TwentyFour, 1-Sep-2020

Mortgage Rates & Swap Costs

- Swap rates have fallen sharply following Bank of England rate cuts
- Mortgage Rates have remained stable – or even increased a little
    - Lending Criteria have also been tightened



- **Looks to be an outstanding opportunity to be originating, locking-in and taking advantage of increased margin**

Sources: Bloomberg, Bank of England, 1-Sep-2020

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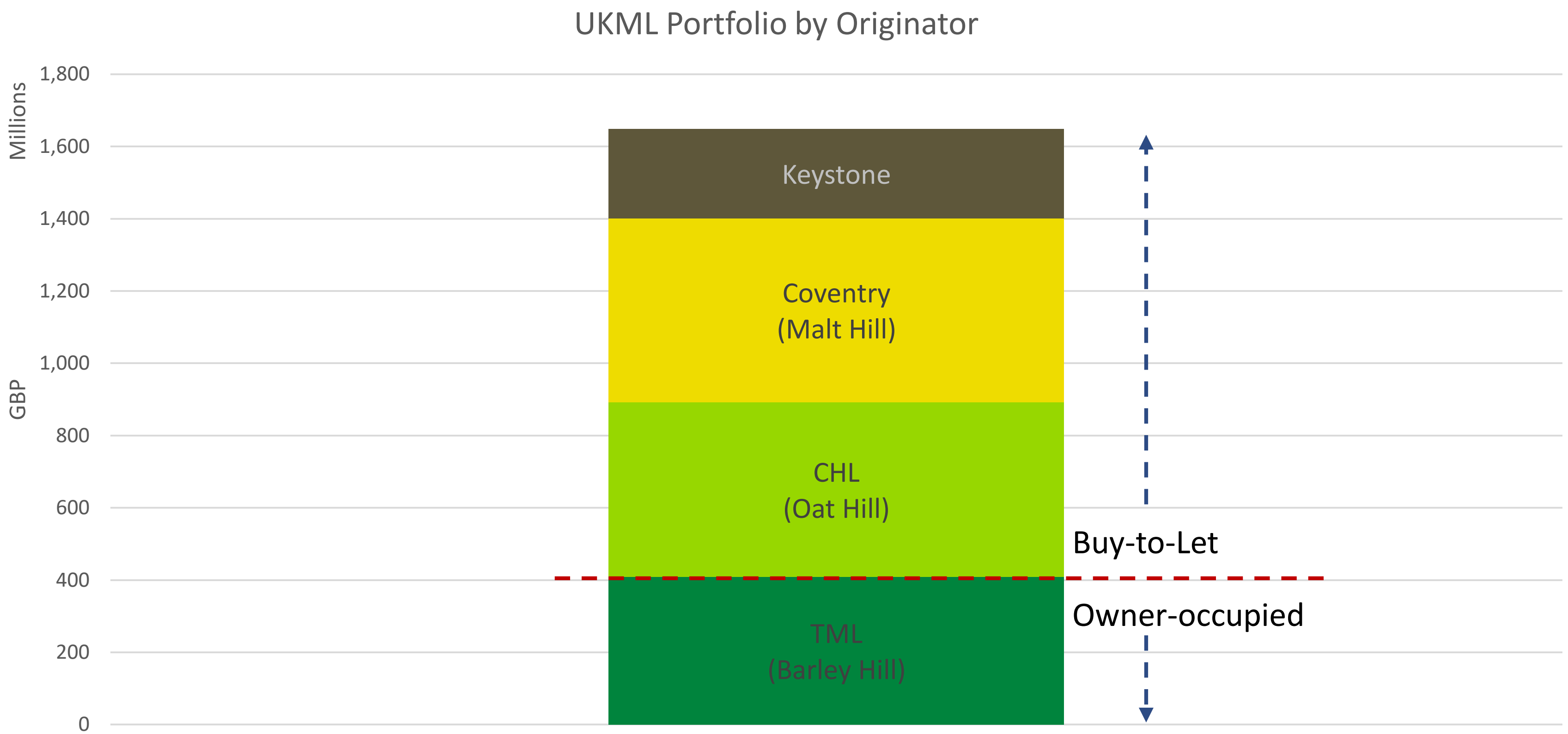
3 Portfolio Update

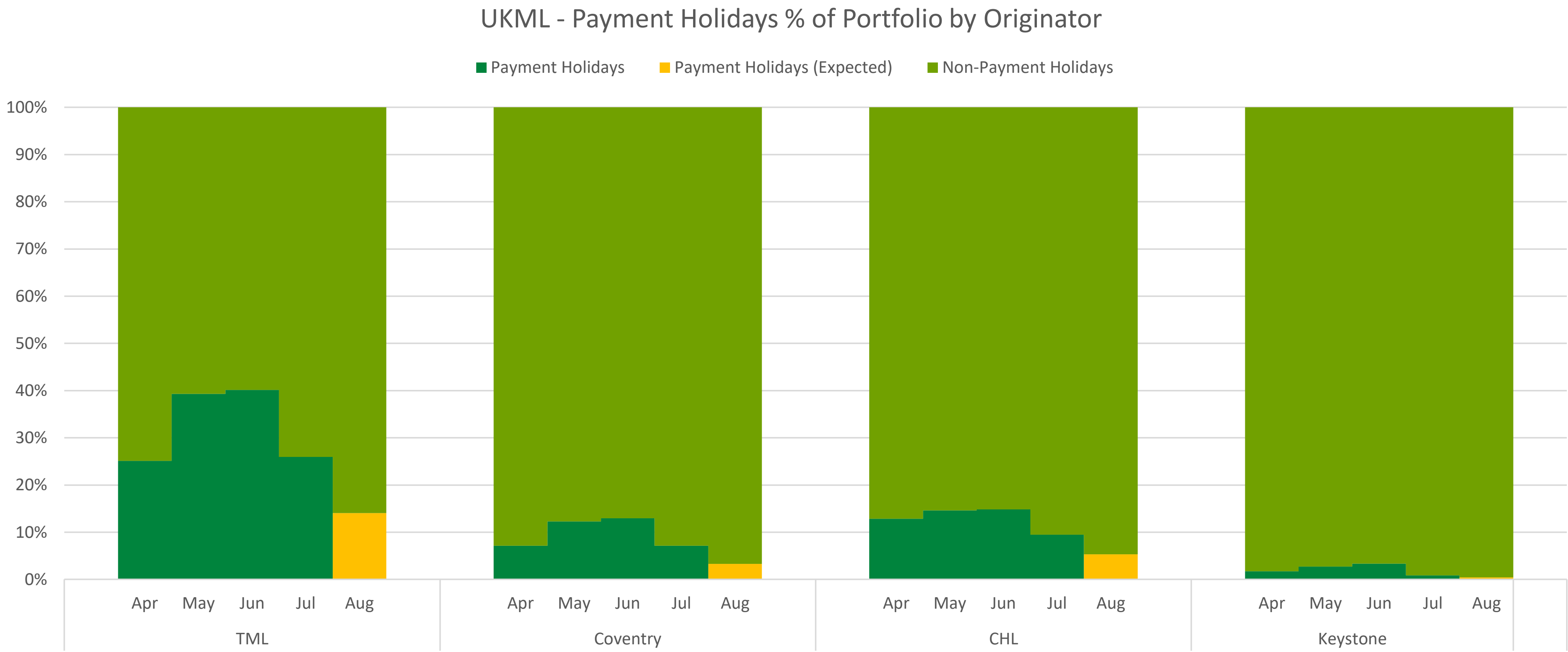
Portfolio Update



- Approx. £1.65bn of loans
  - Ongoing growth from forward flow portfolios – expect term-out securitisations when portfolios reach critical mass
  - BTL portfolios will amortise slowly
  - TML loans pay down steadily as majority are 2-year loans

Sources: TwentyFour, Investor Reports 31-Jul-2020

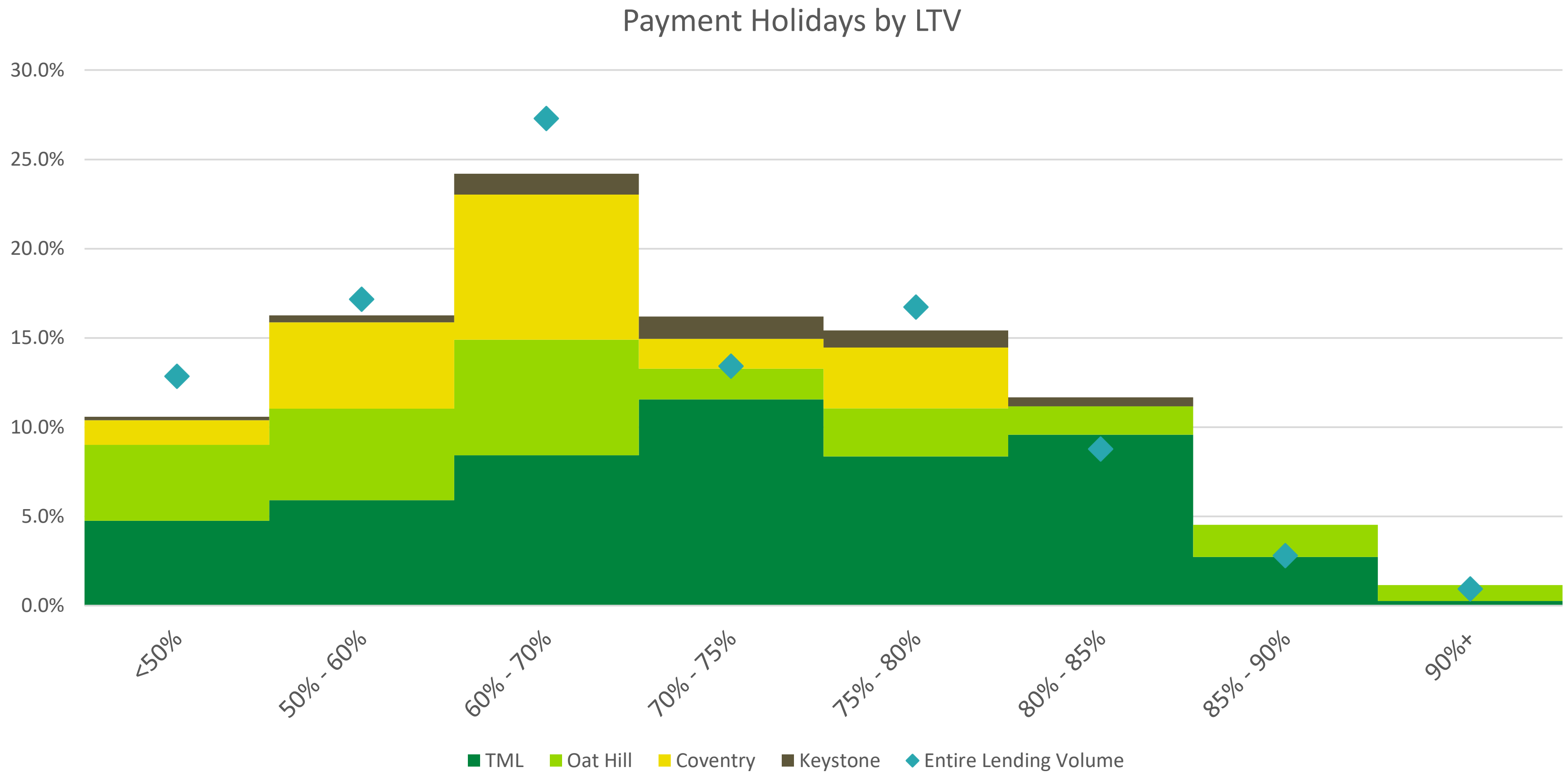
Payment Holiday Experience



- Payment Holidays continue to reduce
  - Further reductions expected towards end of scheme on 31-Oct
- Some residual expected that are now modelled as arrears

Sources: TwentyFour, Investor Reports 31-Jul-2020

Payment Holiday Exposure



- Overall portfolio has low exposure to higher LTVs
- Payment Holiday exposure generally in line with overall portfolio
  - No significant exposure to higher LTV bands

Sources: TwentyFour, Investor Reports 31-Jul-2020

Conservative Loss Provisioning

- Low exposure to higher LTVs helps afford significant protection against potential defaults
- ***BUT***
- Some defaults, and therefore potential losses, look to be inevitable particularly given increased unemployment due to Covid

    - Updated, highly detailed, loss provisioning model developed alongside our auditors
        - Loan-by-loan analysis
        - Tailored probability of default analysis for each portfolio
            - Probability of default loading doubled for loans with payment holidays
            - Scaled-up default weightings as LTVs increase
        - Significant house price declines in all scenarios plus additional haircuts and interest shortfalls for higher stress cases
            - *Minimum of 16.5% for base case*
            - *Up to 68% for some severe stress cases*

- Outcome increased our existing provision of £1.45m by approx. £1.1m (approx. 0.5% of NAV)
- We believe the low outcome demonstrates the conservative risk profile of the loan portfolios

Sources: TwentyFour, NAV 30-Jun-2020

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Cashflows, Income and Dividend Cover

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Income Overview – Input Assumptions

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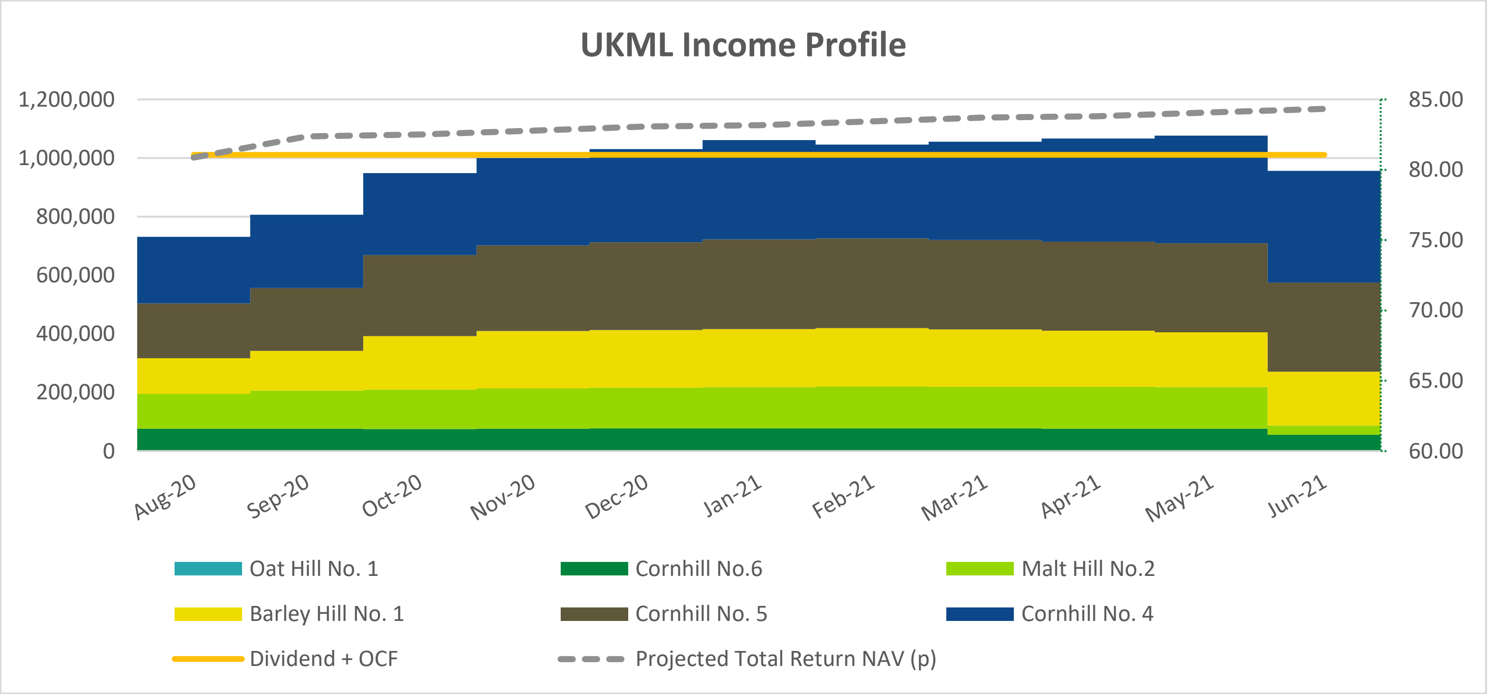
Broad Assumptions

- Return to future dividend of 4.5p from September 2020 (payable in October)
- Also pay an interim dividend to replenish March and June reductions
- Continue to fund forward flow commitments (approx. £20m growth per month)
- Buyback up to 14.99% of shares – reducing overall dividend outgoing
- Payment Holidays fall on trend until after October but then become arrears



Sources: TwentyFour 1-Sep-2020

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Valuation Methodology

Amortised Cost vs Fair Value

Amortised Cost

- Typically used to value illiquid and not easily traded debt assets
    - No transparent pricing
    - Opaque/complex/non-comparable to analyse
    - Often acquired at a discount/premium
    - *Held to maturity*
- Widely used by banks and other lenders/originators/sponsors

Fair Value

- Used to value more regularly traded assets (e.g. listed securities)
    - Visible/comparable pricing
    - More vanilla analysis through industry standard systems (e.g. Bloomberg)
    - *Assets typically expected and easily able to be traded*
- Highly relevant to bond portfolios

How does it work for mortgage portfolios?

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Amortised Cost

- The principal repayment profile of the assets will be amortised using appropriate input assumptions
  - E.g. a portfolio of 25 year mortgages might have an expected 10 year life after modelling prepayments etc.
- Any purchase premium or discount is amortised to par (less any expected losses) over the expected life
  - E.g. a 2% purchase premium over a 10 year expected life would amortise to par at approx. 0.2% per annum
  - Any variation experienced will adjust the amortisation profile for future assumptions

Fair Value

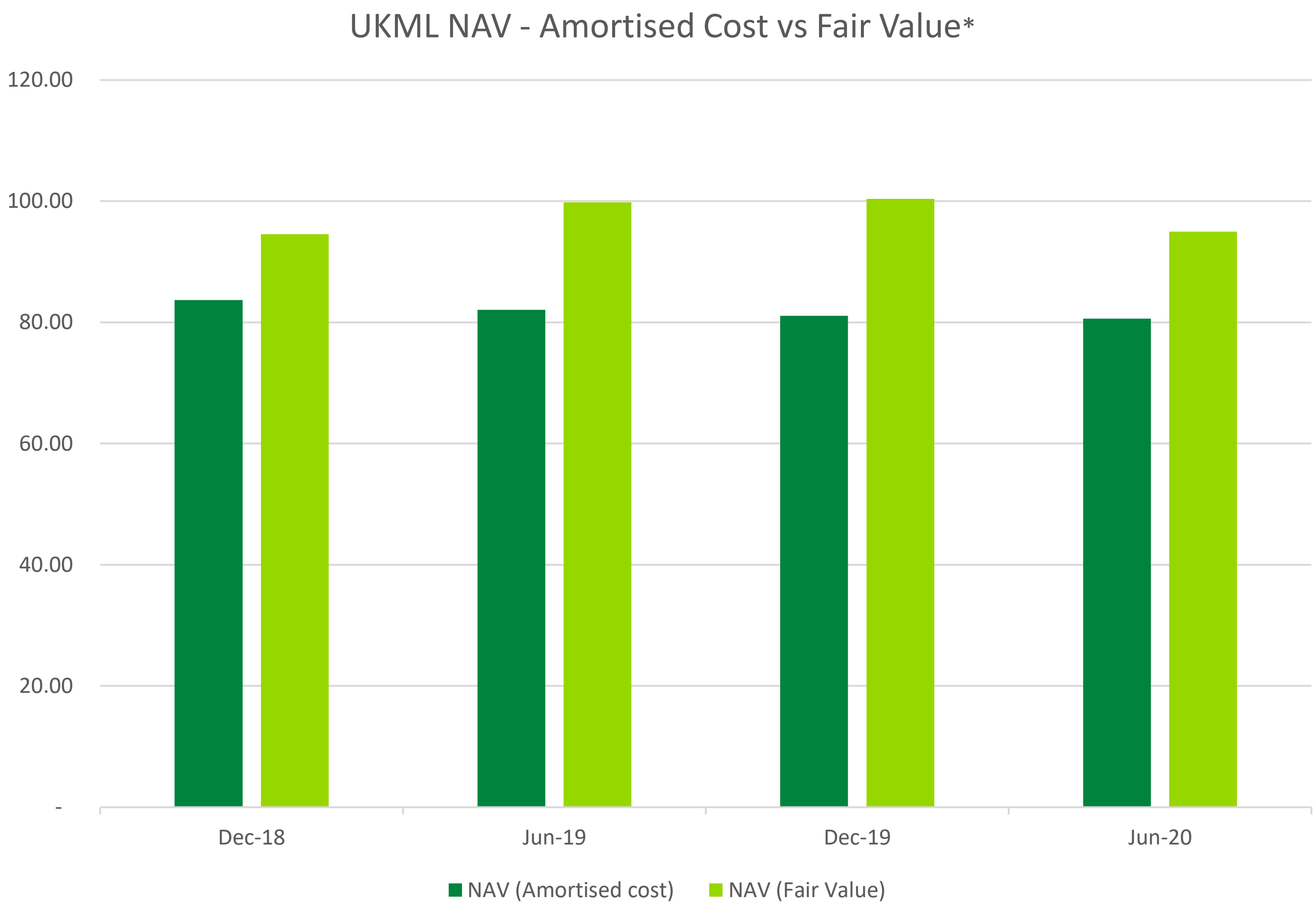
- The profile of the assets will be modelled using the same input assumptions
  - The "point in time" value of each portfolio will be determined assuming the pool is funded through a full securitisation structure at current market levels, adjusted for the mark to market value of any hedges (where assets are fixed rate)
- This method takes no account of any current funding costs or term already in place

- ***All of UKML's portfolios are term funded via existing securitisations to staggered maturities***
  - ***As a result Fair Value is not projected to represent a simple realisable value***

Source: TwentyFour

Amortised Cost vs Fair Value

- The fair value of our portfolios is calculated and reported for the overall portfolio in each of the Fund's semi-annual financial reports



Sources: TwentyFour NAVs 30-Jun-2020
*includes an adjustment for the portion of swap hedges included in the amortised cost

Securitisation Example

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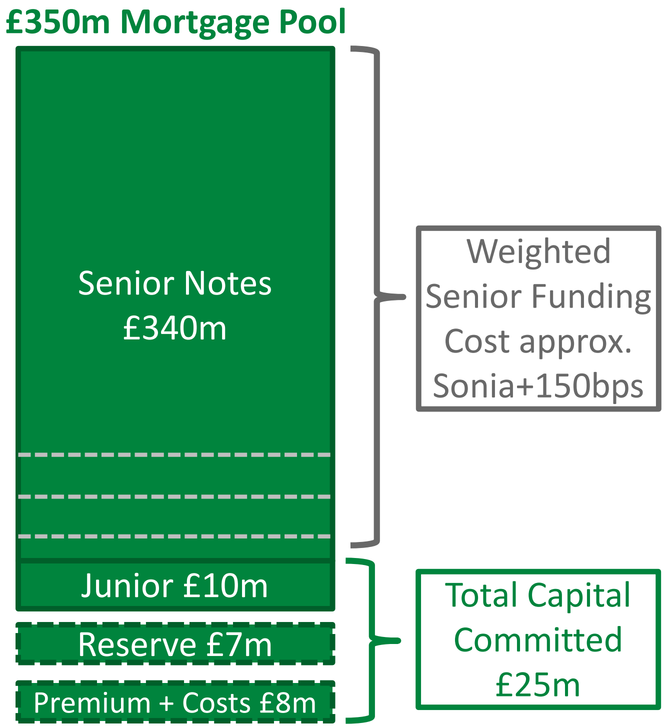
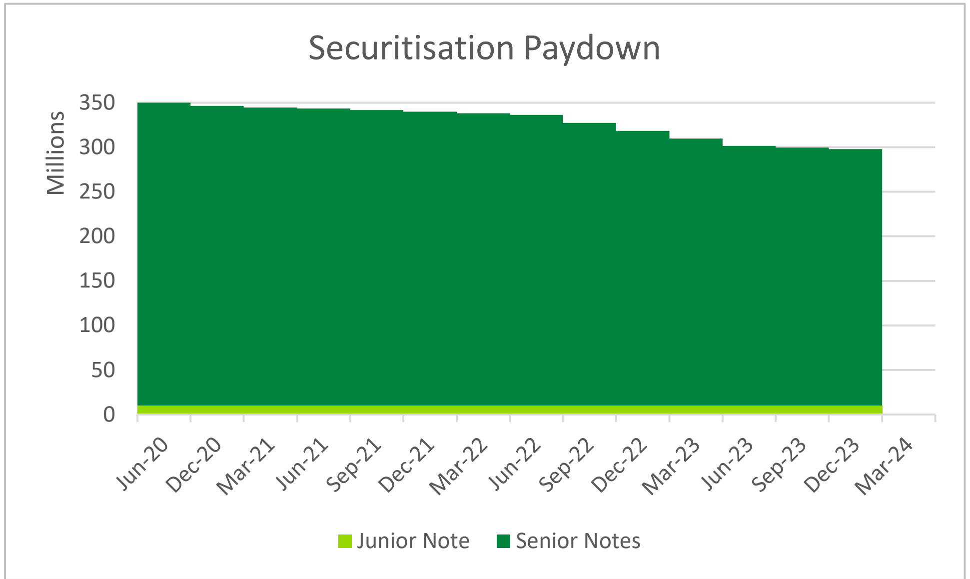
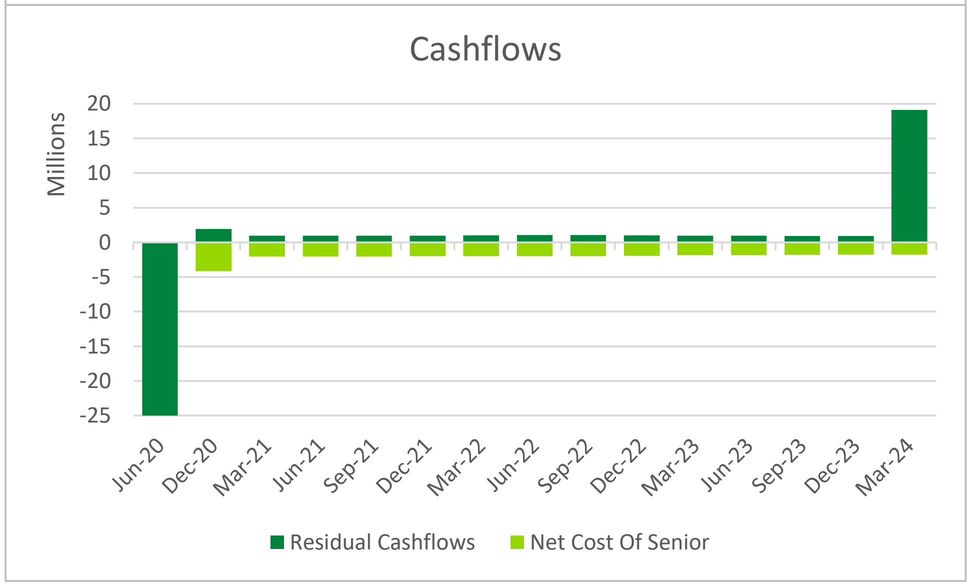
Securitisation Example



Net Interest Margin	1.00%
Leverage	14x
Net Yield	c.9.5%





For illustrative purposes to demonstrate the typical structure and not based on a particular security.
Sources: TwentyFour 1-Sep-2020

7 Summary

The Future?

- Strategic review starts here
    - All options considered

- We have six high quality, low LTV portfolios
- We have only just started being able to implement the revised investment policy agreed last year
    - More appropriate leverage
        - To enable a covered dividend
        - And regrow the NAV
    - Share buybacks to narrow the discount
    - Restore investor confidence
- ***BUT***
    - We have heard investors
    - Liquidity is important

- **Consistent, sustainable returns with covered dividends are paramount to our focus**

Sources: TwentyFour

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