

FOLK2FOLK

FOLK2FOLK RISK CATEGORY METHODOLOGY

(March 2026)

In accordance with Financial Conduct Authority (FCA) requirements effective from 9th December 2019, FOLK2FOLK publishes an [Outcomes Statement](#) within four months of the end of each financial year (our financial year end is 31st Jan). This document provides the methodology work behind FOLK2FOLK's loan risk categories and expected default rate and losses assumptions.

BACKGROUND

Loan products

FOLK2FOLK offers Secured Loans for business purposes with loan terms from 6 months up to 5-years. All loans are secured against UK land or property (but not the Borrower's primary home), with fixed rate interest payments payable monthly to investors. Typically, FOLK2FOLK lends up to around 60% loan to value (LTV).

Under the Security Charge that underpins the lending, FOLK2FOLK has the right to act on the investors' behalf to enforce the security, which typically will be a sale by LPA Receivers.

Definition of default

The FCA's definition of default is when the Borrower is **180 days** past the contractual payment due date. Internally, FOLK2FOLK defines a loan as in default when it is **14 days** past the contractual payment date. Upon trigger of default, a higher Standard Interest Rate will be applicable on the loan until the point when the loan is fully repaid or returned to Good Standing. Where data and calculations are applied in this methodology, it is clearly noted which definition of default has been used.

Security Type

In accordance with Bank of England reporting standards for secured lending, we categorise our real estate securities into the following categories. If the security of the loan is made up of a number of parts and does not fall strictly in one of the below categories, we will then categorise according to the security with the highest value.

- **Residential Properties:** This refers to investment properties or buy-to-let properties designated for residential use. These may be tenanted. The security is never solely made up of the Borrower's home as Residential Mortgage Contracts are out of scope for FOLK2FOLK.
- **Commercial Properties:** These are buildings with commercial uses; typically farm buildings, shops/retail, guesthouses/hotels, offices, menage/equine arenas, industry units/manufacturing workshops and may include some land.
- **Land only:** These will be categorised as land only with no buildings or fixtures. Typical examples in FOLK2FOLK's loan book are: agricultural land or development land with prospective planning (before construction begins).

METHODOLOGY

Our expected default and loss assumptions is based on the following variables to feed into the calculation:

- **Probability of Default (PD)**
- **Recovery Cost on enforcement**
- **Loss Given Default (LGD)**

1. Probability of Default (PD)

This is the probability that an event happens; in this case the event concerned is when a loan is default for 180-days.

In order to determine the PD, we have referred to similar UK small balance commercial mortgage-backed securities. One such prominent comparable was the Together Asset Backed (TAB) Securitisation 2025-CRE-1 Plc which was rated by Morning Star DBRS¹ in March 2025.

For the purpose of demonstration, the table below outlines the key characteristics between FOLK2FOLK's loan book and the TAB Securitisation note.

	FOLK2FOLK	TAB
Cut-Off Date	31 January 2026	31 January 2025
Portfolio Balance	£201,148,801	£522,229,071
Number of Loans	448	2,208
Weighted Coupon	9.2%	10.1%
Weighted Original Loan-To-Value (%)	52.5%	59%
Weighted-Average Original Terms	3.4 years	14 years
Interest-Only Loans	100%	60.2%
Securities: Commercial	70%	83%
Securities: Land	23%	8%

We consider the overall characteristics of the portfolio similar and relevant to FOLK2FOLK's loan book, therefore several variables in TAB's credit rating report are applied to our methodology, such as applying the base assumption that the expected PD for TAB note is 3.5%.

In order to improve the granularity of our PD assumptions, we split our loan LTVs into the following three categories based on value at drawdown. It can be assumed that the higher the LTV, the higher the interest rate of the loan may be, therefore it can put pressure on the serviceability of the loan and may increase potential of missed payment (and consequently default).

	Probability of Default (PD)
LTV: 0-30%	3%
LTV: 30-60%	3.5%
LTV: 60-70%	4.5%

The above assumptions are based on a stable economic environment. If the reporting period occurs during a relatively weak economic climate or a relatively elevated part of the rate cycle, an **economic multiplier** may be applied to the PD, from time to time, to derive the Expected Default Rate.

¹ [Together Asset Backed Securitisation 2025-CRE1 Plc: Credit Rating Report | Morningstar DBRS](#)

2. Recovery Cost

The next variable which affects the Expected Loss is the reduction in the return during the course of the recovery action.

Recovery Period is a factor in relation to the additional default interest rate that is being accrued.

Enforcement Cost is the assumption that most recovery actions will require third-party involvement (lawyers, receivers, advisors, security holding costs when appropriate). Such costs associated with foreclosure are deducted from the net sale proceeds (after selling agents and conveyancing legal costs). Therefore, we apply the UK foreclosure costs based on Morningstar's methodology² at 3% of the property value.

Value Decline is the assumption that properties sold under foreclosure will experience a discount (Distressed Sale Discount) on the Open Market Value obtained prior to loan drawdown. These may be because the property is sold under forced-sale timing or the value of the property may have declined during the course of the loan (Market Value Decline). In Morningstar's methodology for TAB, the Distressed Sale Discount applied for all Commercial Loans is 35%. However, considering FOLK2FOLK's conservative approach, we set the Commercial Value Decline at 30%, while residential properties will benefit from a lower discount (20%) and pure Land securities might experience a higher fluctuation of up to a 40% discount.

	Residential	Commercial	Land
Recovery Period (year)	1.5		
Enforcement Cost	3%		
Value Decline	20%	30%	40%

Combining the above assumptions into the LTV at drawdown, the recovery cost associated with the LTV categories is represented below as the value erosion during recovery process:

Recovery Cost	Residential	Commercial	Land
LTV: 0-30%	38%	48%	58%
LTV: 30-60%	38%	48%	58%
LTV: 60-70%	40%	50%	60%

3. Loss Given Default (LGD)

Given we have set the parameters on the value erosion, the lower the starting LTV the higher buffer from the erosion and hence will have a lower LGD.

$$\text{Loss Given Default} = 1 - \text{Recovery Cost} - \text{LTV limit}$$

The resulting LGD by security type and by LTV category is therefore:

Loss Given Default (LGD)	Residential	Commercial	Land
LTV: 0-30%	0%	0%	0%
LTV: 30-60%	0%	8%	18%
LTV: 60-70%	10%	20%	30%

² Morningstar DBRS European RMBS Insight Methodology (February 2026) ([475548.pdf](#))

The calculation above assumes the upper limit of each category. An LGD of 0% means full recovery (i.e. no losses). Therefore, the lower the LTV, the higher the buffer against value erosion during the course of recovery and the more likely to achieve full recovery.

4. Outcome: Expected Loss (EL)

Loss Given Default tells the assumption of loss once the default event occurs. Therefore, the Expected Loss for an investment is the multiplier of Probability of Default (PD) and Loss Given Default (LGD), i.e. the likelihood default happens adjusted by the loss that might be borne.

$$\text{Expected Loss} = PD \times LGD$$

Therefore, the EL based on loan LTV and the security type is as follows.

Expected Loss (EL)	Residential	Commercial	Land
LTV: 0-30%	0.0%	0.0%	0.0%
LTV: 30-60%	0.0%	0.3%	0.6%
LTV: 60-70%	0.4%	0.9%	1.3%

CONCLUSION

An EL of 0% means a full recovery is expected (no losses). Therefore, the higher the LTV, the higher the EL for investors. Land securities also have more chances of a loss due to the higher value decline assumptions under the recovery scenario, while in contrast, Residential Properties are the most defensive when it comes to recovery and enforcement. This methodology is considered relevant and appropriate as the resulting range of FOLK2FOLK's EL is in line with TAB's base case EL at 0.4%.