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**Research Update:**

# Astoria Financial Corp. Downgraded To 'BBB-', Astoria Federal Savings & Loan To 'BBB'; Outlook Negative

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## Research Update:

# Astoria Financial Corp. Downgraded To 'BBB-', Astoria Federal Savings & Loan To 'BBB'; Outlook Negative

## Overview

- We increased our estimates of industry loan losses, given the severity of the national recession.
- We are concerned about Astoria's moderate exposure to limited-documentation residential mortgages and its modest earnings generation and capital levels.
- We are downgrading Astoria Financial Corp. to 'BBB-' and Astoria Federal Savings & Loan to 'BBB', while affirming the short-term rating on Astoria Federal at 'A-2', lowering the preferred stock rating to 'BB-' from 'BB+', and removing the ratings from CreditWatch. The outlook is negative.
- If net charge-offs remain low and NPL trends stabilize over the next several quarters, we could revise the outlook to stable

## Rating Action

On June 17, 2009, Standard & Poor's Ratings Services lowered its long-term counterparty rating on Astoria Financial Corp. (Astoria) by one notch, to 'BBB-' from 'BBB', and the preferred stock rating by two notches, to 'BB-' from 'BB+'. At the same time, we lowered our long-term counterparty credit rating on Astoria Federal Savings & Loan to 'BBB' from 'BBB+' and affirmed the short-term rating on Astoria Federal at 'A-2'. We removed all ratings from CreditWatch, where they were placed with negative implications on May 4, 2009. The outlook is negative.

## Rationale

The rating action follows our recent industry review, in which we reevaluated our expectations for industry loan losses in light of the severity of the national recession. The downgrade reflects our concerns about Astoria's asset quality trends, coupled with its modest earnings power and capital levels. The lowering of the preferred stock rating by two notches better aligns the notching of this rating with peers and incorporates our view of the risks of heightened preferred stock dividend deferrals in the industry amid the current industry downturn.

Although as a single-family mortgage lender Astoria does not have a very high-risk profile, a particular risk is the accelerated asset quality deterioration in Astoria's low-documentation (Alt-A) residential mortgage portfolio, which represents about 20% of residential mortgages and 15% of total loans. Astoria reported a sharp rise in nonperforming loans (NPLs) in first-quarter 2009, although its NPLs-to-loans ratio was still relatively low,

at 2.05% as of March 31--better than that of most regional banks. Somewhat diversified by geography, the single-family portfolio does not have large concentrations in the most distressed housing markets, and we believe the company employs conservative underwriting standards regarding loan-to-value levels. Still, we expect the loan portfolio to weaken further, and, in our view, Astoria's financial profile is vulnerable in the current downturn because of its inherently weak core earnings generation capability. As a thrift, Astoria is highly reliant on spread income, and its net interest margin, though improved since a year ago, tends to be narrow. Furthermore, capital levels are not particularly strong, with tangible common equity to tangible assets of 4.79% as of March 31.

With \$21 billion in assets, Astoria has a good market position as a community depository on Long Island and in Queens and Brooklyn in New York City. We consider this long-standing, solid position in the New York metropolitan-area branch-banking markets as a supportive factor in the rating.

## Outlook

The negative outlook addresses the possibility that asset quality and earnings trends may be worse than we currently anticipate. It also considers the scenario of a worse-than-expected downturn in the New York City metropolitan area economy, to which Astoria is exposed through a portion of its single-family portfolio and through its multifamily loan portfolio. If asset quality deteriorates more than we current expect and/or the company reports losses that significantly affect capital ratios, we could lower the ratings further. Alternatively, if net charge-offs remain low and NPL trends stabilize over the next several quarters, we could revise the outlook to stable.

## Related Research

- "Credit Stress Testing For Financial Institutions," April 29, 2009
- "Methodology And Assumptions: Risk-Adjusted Capital Framework For Financial Institutions," April 21, 2009
- "Stress Testing U.S. Financial Institutions," April 29, 2009

## Ratings List

Downgraded; Off CreditWatch

	To	From
Astoria Financial Corp. Counterparty Credit Rating Senior Unsecured	BBB-/Negative/-- BBB-	BBB/Watch Neg/-- BBB/Watch Neg

Downgraded; Off CreditWatch; Short-Term Ratings Affirmed

	To	From
Astoria Federal Savings & Loan Counterparty Credit Rating Certificate Of Deposit Local Currency	BBB/Negative/A-2 BBB/A-2	BBB+/Watch Neg/A-2 BBB+/Watch Neg/A-2

Downgraded; Off CreditWatch

	To	From
Astoria Capital Trust I Preferred Stock	BB-	BB+/Watch Neg

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