The First Bank Failure of 2008

Bad commercial real estate loans sink a small financial institution in Kansas City.

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A tiny bank in Kansas City, Mo., has become the first bank in the country to fail this year—but it's unlikely to be the last.

Federal regulators on Friday shuttered Douglass National Bank, an African-American-owned bank with $59 million in assets that was named in honor of the 19th-century abolitionist Frederick Douglass. The bank, which has roots stretching back to the 1940s, had struggled of late, losing $1.3 million in 2007 and $4.3 million in 2006.

Although its recent losses were tied to bad commercial real estate loans, not residential mortgages, the bank's problems are nonetheless linked to the global mortgage crisis that has ripped through the financial services industry, says William Michael Cunningham of Creative Investment Research. "It's this secondary and tertiary impact of the crisis in the subprime market that's beginning to impact smaller institutions mainly through [the slowdown in] consumer spending," Cunningham says.

Douglass is the first bank to fail in 2008 and the fourth since February of last year. Before that, federal regulators hadn't shuttered a bank since June 2004.

But Cunningham expects other small banks—especially those with weak profits and deteriorating capital bases—to follow suit in the coming months, as the slowing economy limits borrowers' ability to repay loans.

Larger banks, such as, say, Bank of America or Citigroup, are far less likely to experience a similar rise in failures. Such banks have more capital to protect against losses and greater access to additional funds should they need them.

But with limited resources, smaller banks simply have fewer options, making them more vulnerable to downturns in the industry and the economy as a whole.

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