

**FEDERAL DEPOSIT INSURANCE CORPORATION**

550 17<sup>th</sup> Street, N.W. Washington, D.C. 20429

**FORM 10-QSB**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTER ENDED March 31, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_ TO \_\_\_\_

**FDIC Certificate Number: 20164**

**SUNWEST BANK**

(Exact name of small business issuer as specified in its charter)

**CALIFORNIA**

(State or other jurisdiction of  
incorporation or organization)

**95-2630202**

(IRS Employer  
Identification No.)

**17542 East 17<sup>th</sup> Street Ste 200 Tustin, California**

(Address of principal executive offices)

**92780-1960**

(Zip Code)

**(714) 730-4400**

(Issuer's telephone number)

**N/A**

(Former name, former address, and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2) of the Exchange Act YES  NO

Number of shares outstanding of each of the issuer's classes of common equity as of April 20, 2006: 17,221

Transitional Small Business Disclosure Format. Yes  No

**PART I. FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**SUNWEST BANK AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION - UNAUDITED  
(Dollars in thousands)**

	March 31, 2006	December 31, 2005
	<u>          </u>	<u>          </u>
<b>ASSETS</b>		
Cash and due from banks .....	\$ 13,431	\$ 12,867
Fed funds sold, mutual funds and interest bearing deposits .....	97,025	64,877
Total cash and cash equivalents .....	<u>110,456</u>	<u>77,744</u>
Securities, available for sale ("AFS"), at fair value .....	<u>42,271</u>	<u>58,229</u>
Loans, net of deferred fees .....	147,618	158,336
Allowance for loan losses .....	<u>(2,351)</u>	<u>(2,351)</u>
Net loans.....	145,267	155,985
Investment in Federal Home Loan Bank ("FHLB") stock .....	1,401	1,384
Premises and equipment, net .....	1,292	1,080
Other assets .....	<u>1,665</u>	<u>2,081</u>
Total Assets .....	<u>\$ 302,352</u>	<u>\$ 296,503</u>
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Demand deposits .....	\$ 171,696	\$ 165,000
Money market and savings accounts .....	72,000	76,238
Time deposits .....	<u>16,894</u>	<u>13,695</u>
Total deposits .....	260,590	254,933
FHLB advances .....	5,375	5,375
Accounts payable and other liabilities.....	<u>3,120</u>	<u>3,350</u>
Total Liabilities .....	<u>269,085</u>	<u>263,658</u>
Commitments and contingencies.....	-	-
<b>Shareholder's Equity</b>		
Preferred stock, no par value: 5,000,000 shares authorized, no shares issued and outstanding at March 31, 2006 or December 31, 2005 .....	-	-
Common stock, no par value: 30,000,000 shares authorized, 17,221 shares issued and outstanding at March 31, 2006 and December 31, 2005 .....	27,294	27,159
Retained earnings since November 30, 2002 .....	5,958	5,696
Accumulated other comprehensive income, net of tax.....	15	(10)
Total Shareholders' Equity .....	<u>33,267</u>	<u>32,845</u>
Total Liabilities and Shareholders' Equity.....	<u>\$ 302,352</u>	<u>\$ 296,503</u>

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME - UNAUDITED  
(Dollars in thousands, except per share amounts)

	For the Quarter Ended March 31,	
	2006	2005
Interest income		
Loans.....	\$ 3,156	\$ 3,057
Securities, AFS and trading.....	675	622
Fed funds sold, mutual funds and interest bearing deposits.....	810	215
Total interest income.....	4,641	3,894
Interest expense		
Deposits.....	270	205
Borrowings.....	59	59
Total interest expense.....	329	264
Net interest income.....	4,312	3,630
Provision for loan losses.....	-	96
Net interest income after provision for loan losses.....	4,312	3,534
Noninterest income:		
Deposit charges.....	135	121
Net (loss) gain from sales of securities and trading activities.....	(398)	58
Other income.....	26	41
Total noninterest income.....	(237)	220
Noninterest expense:		
Compensation and benefits.....	1,635	1,422
Occupancy and depreciation.....	534	517
Customer service.....	883	301
Professional services.....	137	328
Other expenses.....	476	542
Total noninterest expense.....	3,665	3,110
Income before taxes.....	410	644
Income taxes.....	148	241
Net income.....	\$ 262	\$ 403
Net income per share:		
Basic.....	\$ 15.21	\$ 23.44
Diluted.....	15.13	23.39
Shares used to compute:		
Basic net income per share.....	17,221	17,193
Diluted net income per share.....	17,316	17,228

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN  
STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME - UNAUDITED  
(Dollars in thousands)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
	Shares	Amount			
Balance, December 31, 2004 ....	17,187	\$ 27,063	\$ 3,556	\$ 526	\$ 31,145
Net income.....	-	-	403	-	403
Other comprehensive income, net of tax:.....				(285)	(285)
Common stock issued.....	8	17	-	-	17
Balance March 31, 2005 .....	<u>17,195</u>	<u>\$ 27,080</u>	<u>\$ 3,959</u>	<u>\$ 241</u>	<u>\$ 31,280</u>
Balance, December 31, 2005 ....	17,221	\$ 27,159	\$ 5,696	\$ (10)	\$ 32,845
Net income.....	-	-	262	-	262
Other comprehensive income, net of tax .....	-	-	-	25	25
Stock-based compensation expense .....	-	135	-	-	135
Balance, March 31, 2006 .....	<u>17,221</u>	<u>\$ 27,294</u>	<u>\$ 5,958</u>	<u>\$ 15</u>	<u>\$ 33,267</u>

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED  
(Dollars in thousands)

	Year the Quarter Ended March 31,	
	2006	2005
<b><u>Cash Flows from Operating Activities</u></b>		
Net income .....	\$ 262	\$ 403
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization .....	108	105
Provision for loan losses.....	-	96
Deferred income taxes.....	149	(82)
Net loss (gain) on sales of securities and trading activities .....	398	(58)
Amortization and accretion of AFS securities.....	7	89
Dividends of FHLB Stock.....	(17)	-
Stock-based compensation expense .....	135	-
Decrease in other assets.....	250	545
Decrease in other liabilities .....	(114)	(254)
Net cash provided by operating activities.....	1,178	844
<b><u>Cash Flows from Investing Activities</u></b>		
Proceeds from maturities and repayments of securities .....	649	2,023
Purchases of AFS securities .....	-	(14,772)
Proceeds from sale of securities AFS.....	14,946	9,004
Net increase (decrease) in loans, net of purchases .....	10,718	(4,646)
Purchases of premises and equipment.....	(320)	(32)
Net cash provided by (used in) investing activities .....	25,993	(8,423)
<b><u>Cash Flows from Financing Activities</u></b>		
Increase (decrease) in deposits .....	5,657	(28,165)
Payments for fractional shares relating to 2004 stock split.....	(116)	(1,556)
Proceeds from exercise of common stock options .....	-	17
Net cash provided by (used in) financing activities.....	5,541	(29,704)
Increase (decrease) in cash and cash equivalents .....	32,712	(37,283)
Cash and cash equivalents at beginning of period.....	77,744	59,247
Cash and cash equivalents at end of period.....	\$ 110,456	\$ 21,964
<b><u>Supplemental disclosures of cash flow information:</u></b>		
Cash paid during the period for:		
Interest .....	\$ 264	\$ 202
Income taxes .....	35	170

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
March 31, 2006  
(Unaudited)

**Basis of Presentation**

The consolidated financial statements include the accounts of Sunwest Bank and its wholly-owned subsidiaries, Sunwest Leasing Corp, North Orange County Bancorp and WCV, Inc. All significant intercompany balances have been eliminated. The results of operations reflect any interim adjustments, all of which are of a normal recurring nature and which, in the opinion of management, are necessary for a fair presentation of the results for the interim period presented. The results for the 2006 interim period are not necessarily indicative of the results expected for the full year.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-QSB and the rules and regulations of the Federal Deposit Insurance Corporation and include all information and footnotes required for interim financial statement presentation. The financial information provided herein, including the information under the heading Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), is written with the presumption that the users of the interim financial statements have read, or have access to, the most recent Annual Report on Form 10-KSB which contains the latest available audited consolidated financial statements and notes thereto, as of December 31, 2005 together with the MD&A as of such date.

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain reclassifications have been made to the prior year's consolidated financial statements to conform to the 2006 presentation.

**Earnings Per Share**

The following table provides information used to calculate earnings per share as of the periods indicated (dollars in thousands except per share amounts):

	For the Quarter Ended	
	March 31,	
	2006	2005
Net income.....	\$ 262	\$ 403
Weighted average number of common shares outstanding:		
Basic shares .....	17,221	17,193
Dilutive effect of restrictive stock grants.....	64	-
Dilutive effect of stock options.....	31	35
Dilutive .....	17,316	17,228
Net income per share:		
Basic .....	\$ 15.21	\$ 23.44
Diluted .....	15.13	23.39

The Bank has 1,853 stock options outstanding that could potentially dilute EPS in future periods that were excluded from the above computations because the impact of including them was antidilutive.

## **Recent Accounting Developments**

In December 2004, the Financial Accounting Standards Board (FASB), issued SFAS No. 123 (revised 2004), "Share—Based Payment" ("Statement 123R"). This Statement requires that compensation costs related to share-based payment transactions be recognized in the financial statements. Measurement of the cost of employee service will be based on the grant-date fair value of the equity or liability instruments issued. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. Additionally, liability awards will be re-measured each reporting period. Statement 123R replaces SFAS No. 123, "Accounting for Stock-Based Compensation" and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". The Bank adopted Statement 123-R effective January 1, 2006 for all new stock option awards as well as any existing awards that have been modified, repurchased or cancelled. In addition, the unvested portion of previously awarded options has been recognized in the current period financial statements. The Bank recognized \$119, 000 of expense in 2006 as a result of the adoption of Statement 123-R. In 2005, the pro-forma impact of expensing stock options was immaterial.

## **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Cautionary Statement Regarding Forward-Looking Statements**

Certain statements in this Report on Form 10-QSB constitute "forward-looking statements" under the Private Securities Litigation Act of 1995, which involve risks and uncertainties. Although we believe that the expectations reflected in our forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors (some of which are beyond our control). These factors include, but are not limited to: the strength of the United States economy in general and the strength of the regional and local economies within California; inflation, interest rate and monetary fluctuations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; the effect of government regulation generally and any supervisory or regulatory orders, specifically; adverse changes in the local real estate market, as our loans are concentrated in California and significant majority of these loans have real estate as collateral; geopolitical conditions, including acts or threats of terrorism, actions taken by the United States or other governments in response to act or threats of terrorism and/or military conflicts which could impact business and economic conditions in the United States and abroad; and the impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies. In addition, factors which may affect our forward-looking statements are set forth in our Annual Report on Form 10-KSB under the heading "Business Considerations and Certain Factors that May Affect Future Results of Operations and Stock Price" and in our other current and periodic filings with the FDIC.

We do not intend, and specifically disclaim any obligation to update our forward-looking information and statements, whether written or oral, to reflect changes. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.

### **CRITICAL ACCOUNTING POLICIES**

The following discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, and the notes thereto, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in our consolidated financial statements. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. We believe that our estimates and assumptions are reasonable in the circumstances; however, actual results may differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and our results of operations for the reporting periods.

Our allowance for loan losses is established through a provision for loan losses charged to expense and may be reduced by a recapture of the allowance, which is also reflected in the statement of income. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible based on an evaluation of the collectibility of loans and prior loan loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrower's ability to pay. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic or other conditions.

### **CHANGES IN FINANCIAL CONDITION**

*Overview:* Sunwest Bank's financial condition has not changed significantly over the past few years. We fund our interest earning assets, (loans and investment securities), primarily with low cost deposits. Our only borrowing is a \$5.4 million FHLB advance. We continue to maintain high levels of liquidity as we invest our available funds in short-term investments (federal funds, certificates of deposits and money market mutual funds) or in securities. Our loan portfolio has decreased slightly as payoffs and paydowns have exceeded internally generated loan originations. Our deposit base is growing as we continue to focus our marketing efforts on core deposit growth. Our capital position is strong as our current regulatory capital levels are well in excess of the minimum levels required to be considered a "well capitalized" institution.

*Cash and cash equivalents and securities:* Between December 31, 2005 and March 31, 2006, cash and cash equivalents increased \$32.7 million due primarily to the sale of investment securities and the overall decrease in the loan portfolio. During the first three months of 2006, we sold \$15.3 million of US Treasury securities with a weighted average yield of 3.77%, resulting in a loss on sale of \$0.4 million.

*Loans:* The following table provides a breakdown of our loan portfolio as of the dates indicated (dollars in thousands):

	March 31, 2006	December 31, 2005
Commercial.....	\$ 48,703	\$ 55,396
Real estate – other.....	53,859	57,892
Real estate – construction .....	41,539	40,456
Personal loans .....	3,848	4,893
Total loans .....	147,949	158,637
Allowance for estimated loan losses.....	(2,351)	(2,351)
Deferred loan fees and expenses.....	(331)	(301)
Total loans, net.....	<u>\$ 145,267</u>	<u>\$ 155,985</u>

During the first quarter of 2006, total loans decreased \$10.7 million as a result of \$21.3 million of payoffs and collections of principal, net of advances, on existing loans, offset in part by \$10.6 million of fundings of new loans.

*Deposits:* The Bank's deposits as of March 31, 2006 increased by \$5.6 million when compared to December 31, 2005 while average deposits during the first quarter of 2006 were \$9.2 million higher than the corresponding period in 2005. This increase was primarily a result of our continuing marketing efforts and increased deposits from existing customer relationships.

*Borrowings:* As of March 31, 2006, our only borrowing consisted of a \$5.4 million FHLB advance, which matures in June of 2009. While we have the ability to borrow additional funds from the FHLB and other sources, we do not anticipate utilizing any additional borrowings in the near future due to our high level of liquidity.

## RESULTS OF OPERATIONS

### Overview

The following table provides selected financial information related to our results of operations for the periods indicated (dollars in thousands):

	For the Quarter Ended March 31,	
	2006	2005
Income before taxes.....	\$ 410	\$ 644
Net income.....	262	403
Ratio of net income to: (annualized)		
Average shareholders equity.....	3.19 %	5.11 %
Average total assets .....	0.35 %	0.55 %

Our income before taxes, which decreased \$0.2 million in the first quarter of 2006 as compared to the corresponding period in 2005, was primarily impacted by the \$0.4 million loss on the sale of investment securities and higher interest rate environment. The \$0.7 million increase in net interest income in the first quarter of 2006 as compared to the first quarter of 2005 reflects the benefits realized as a result of the higher interest rate environment. Additionally, as a result of the higher interest rate environment, the Bank increased the analysis earnings credit provided to its business customers and this has resulted in higher customer service charges of \$0.5 million for the first quarter of 2006 over the comparable period in 2005.

## Net Interest Income

The following table sets forth, for the periods indicated, information regarding (i) the total dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rate; (iii) net interest income; (iv) interest rate spread; and (v) net interest margin (dollars in thousands):

	For the Quarter Ended March 31,					
	2006			2005		
	Average Balance	Interest	Average Yield /Cost	Average Balance	Interest	Average Yield /Cost
<b>Interest earning assets:</b>						
Loans .....	\$ 156,028	\$ 3,156	8.13 %	\$ 176,982	\$ 3,057	6.94 %
Securities, AFS .....	57,520	658	4.64	50,386	530	4.27
Trading securities.....	-	-	-	10,129	79	3.16
Fed funds sold / mutual funds ...	75,210	810	4.31	38,149	215	2.25
FHLB Stock .....	1,387	17	4.97	1,434	13	3.68
Total interest earning assets .....	290,145	4,641	6.43	277,080	3,894	5.65
Noninterest earning assets.....	12,701			15,317		
Total assets.....	<u>\$ 302,846</u>			<u>\$ 292,397</u>		
<b>Interest bearing liabilities:</b>						
Deposits:						
Interest bearing demand.....	\$ 28,074	12	0.17	\$ 29,437	11	0.15
Money market.....	68,496	142	0.84	75,928	134	0.72
Time and savings .....	19,990	116	2.35	19,316	60	1.26
Total deposits.....	116,560	270	0.94	124,681	205	0.67
Borrowings .....	5,375	59	4.39	5,375	59	4.39
Total interest bearing liabilities....	121,935	329	1.09	130,056	264	0.82
Noninterest bearing deposits .....	144,292			127,016		
Other noninterest bearing liabilities.....	3,231			3,708		
Shareholders' equity .....	33,388			31,617		
Total liabilities and equity.....	<u>\$ 302,846</u>			<u>\$ 292,397</u>		
Net interest earning assets .....	<u>\$ 168,210</u>			<u>\$ 147,024</u>		
Net interest income / interest rate spread.....		<u>\$ 4,312</u>	<u>5.34 %</u>		<u>\$ 3,630</u>	<u>4.83 %</u>
Net interest margin.....			<u>5.94 %</u>			<u>5.24 %</u>

*Interest income:* Our yield on average interest earning assets increased 78 basis points in the first quarter of 2006 compared to corresponding period in 2005, creating additional interest income of \$0.7 million.

The average yield on our loans increased 119 basis points to 8.13% in the first quarter of 2006 from 6.94% in the corresponding period in 2005 while average loans decreased \$20.9 million. The increase in yield is the result of increases of 109 and 146 basis point increases in the yield on our real estate and commercial loan portfolio, respectively. These increases in yields were due to increased rates on this primarily adjustable rate loan portfolio as a result of the increases in short term interest rates in the overall market over the last 15 months. The decrease in average loans is due primarily to a \$19.5 million decrease in our real estate loan portfolio, reflecting significant payoffs in construction loans over the past 15 months.

The yield on fed funds sold and mutual funds increased during the first quarter of 2006 as compared to the corresponding period in 2005, as a result of the increase in short term interest rates in the overall market over the last 15 months.

*Interest expense:* Sunwest Bank has a high proportion of noninterest bearing deposit accounts and very limited levels of borrowing which allow us to fund our operations at a relatively low interest cost. At March 31, 2006, the proportion of noninterest bearing deposit balances to total deposits was 65.9% and our borrowings were only 2.0% of our total liabilities. For the first quarter of 2006, average interest bearing liabilities decreased \$8.1 million, the cost of interest bearing liabilities increased 27 basis points and interest expense increased \$0.1 million when compared to the corresponding period in 2005.

The cost of interest bearing deposits increased 27 basis points to 0.94% for the first quarter of 2006 as compared to 0.67% for the corresponding period in 2005 as a result of the increases in short term interest rates in the overall market over the last 15 months. As a result of our favorable funding base and an \$8.1 million decrease in average interest bearing deposits, interest expense on deposits increased only \$0.1 million for the first quarter of 2006 as compared to the corresponding period in 2005. Our funding costs also benefited from a \$17.3 million increase in the average balances of noninterest bearing deposits in the first quarter 2006 as compared to the corresponding period in 2005.

The Bank has an outstanding note in the amount of \$5.4 million due to the Federal Home Loan Bank, which matures in June 2009 and carries a fixed rate of 4.38%.

*Net interest income / net interest margin:* As a result of the increases in short term interest rates in the overall market over the last 15 months and other funding benefits discussed above, our net interest income increased \$0.7 million and our net interest margin increased 70 basis points to 5.94% for the first quarter of 2006 as compared to the first quarter of 2005.

### Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to (i) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume); (ii) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); and (iii) changes in rate/volume (change in rate multiplied by change in volume) for the periods indicated (dollars in thousands):

	For the Quarters Ended March 31, 2006 and 2005			
	Increase (Decrease) Due to			Net Increase (Decrease)
	Rate	Volume	Rate / Volume	
Interest earning assets:				
Loans.....	\$ 527	\$ (364)	\$ (64)	\$ 99
Securities AFS.....	47	76	5	128
Trading securities.....	-	-	(79)	(79)
Fed funds sold / mutual funds.....	196	209	190	595
FHLB Stock.....	5	-	(1)	4
Change in interest income.....	<u>775</u>	<u>(79)</u>	<u>51</u>	<u>747</u>
Interest bearing liabilities:				
Deposits:				
Interest bearing demand.....	2	(1)	-	1
Money market.....	24	(13)	(3)	8
Time and savings.....	53	2	1	56
Total deposits.....	<u>79</u>	<u>(12)</u>	<u>(2)</u>	<u>65</u>
Borrowings.....	-	-	-	-
Change in interest expense.....	<u>79</u>	<u>(12)</u>	<u>(2)</u>	<u>65</u>
Change in net interest income.....	<u>\$ 696</u>	<u>\$ (67)</u>	<u>\$ 53</u>	<u>\$ 682</u>

### Noninterest Income

Noninterest income for the first quarter of 2006 decreased by \$0.5 million compared to the corresponding period in 2005 due to the gains or losses realized on the sale of investment securities in these periods. From time to time, we may decide to sell securities at which time any gain or loss is recognized.

## Noninterest Expense

Noninterest expense increased \$0.5 million for the first quarter of 2006 as compared to the corresponding period in 2005 due to a \$0.2 million increase in compensation and benefits and a \$0.5 million increase in customer service which were partially offset by a \$0.2 million decrease in professional services. The increase in compensation and benefits is primarily due to the impact of the adoption of FASB 123R in the first quarter of 2006. Eligible third party costs related to analysis earnings credits and paid on behalf of certain of our business customers are recorded as customer service expenses. Because of higher interest rates, the analysis earnings credits provided to certain of our customers were significantly higher in the first quarter of 2006 as compared to the first quarter of 2005, resulting in \$0.5 million of higher customer service costs. The decrease in professional services was due legal costs incurred in the first quarter of 2005 related to the proposed restructuring of Sunwest Bank approved by its shareholders in the fourth quarter of 2004 which were not incurred in the first quarter of 2006.

## Income Taxes

Our effective income tax rate for the three months of 2006 was 36.1% as compared to 37.4% for the corresponding period in 2005. As a result of the merger of West Coast Bancorp with and into Sunwest Bank in 2001, as of January 1, 2005, Sunwest Bank has \$3.4 million of tax benefits available to offset future taxable income relating to the net operating tax loss carryforward of West Coast Bancorp, subject to annual limitations of \$0.9 million.

## Nonperforming Assets and Provision for Credit Losses

At March 31, 2006 and December 31, 2005, we did not have any loans on nonaccrual status. Total delinquent loans or loans up to 90 days delinquent as to interest or principal totaled \$0.3 million at March 31, 2006. There were no delinquent loans at December 31, 2005.

The following table summarizes the activity in our allowance for loan losses for the periods indicated (dollars in thousands):

	For the Quarter Ended	
	March 31,	
	2006	2005
Balance: beginning of period.....	\$ 2,351	\$ 2,218
Provision (benefit) for credit losses .....	-	96
Recoveries of amounts previously charged off.....	-	1
Balance: end of period .....	<u>\$ 2,351</u>	<u>\$ 2,315</u>
Allowance for loan losses as a % of total loans .....	1.59%	1.28%

The allowance for loan losses is derived by analyzing the historical loss experience and asset quality within each loan portfolio segment, along with assessing qualitative environmental factors, and correlating it with the delinquency and classification status for each portfolio segment. We utilize a loan grading system with five classification categories, including assets classified as Pass, based upon credit risk characteristics which categorizes each loan by risk grade allowing for a more consistent review of similar loans. Management has also evaluated the loss exposure of classified loans, which are reviewed individually based on the evaluation of the cash flow, collateral, other sources of repayment, guarantors and any other relevant factors to determine the inherent loss potential in the credit.

Management considers the following qualitative environmental factors in determining the allocated loss factors when analyzing the allowance for loan losses: the levels of and trends in past due, nonaccrual and impaired loans; levels of and trends in charge-offs and recoveries; the trend in volume and terms of loans; the effects of changes in credit concentrations; the effects of changes in risk selection and underwriting standards, and other changes in lending policies, procedures and practices; the experience, ability and depth of management and other relevant staff; national and local economic trends and conditions; and industry conditions.

Management believes that its allowance for loan losses at March 31, 2006 was adequate. Nevertheless, there can be no assurance that additions to such allowance will not be necessary in future periods. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our valuation allowance. These agencies may require increases to the allowance based on their judgments of the information available to them at the time of their examination.

## Liquidity

The objective of liquidity management is to ensure that we have the continuing ability to maintain cash flows that are adequate to fund our operations and meet our debt obligations and other commitments on a timely and cost-effective basis. Our liquidity management is both a daily and long-term function of funds management. Liquid assets are generally invested in short-term investments such as federal funds sold and certificates of deposit. If we require funds beyond our ability to generate them internally, various forms of both short and long-term borrowings provide an additional source of funds.

Liquidity management at Sunwest Bank focuses on its ability to generate sufficient cash to meet the funding needs of current loan demand, deposit withdrawals, principal and interest payments with respect to outstanding borrowings and to pay operating expenses. Sunwest Bank monitors its liquidity in accordance with guidelines established by its Board of Directors and applicable regulatory requirements. Sunwest Bank's need for liquidity is affected by its loan activity, net changes in deposit levels and the scheduled maturities of its borrowings. The principal sources of the Bank's liquidity consist of deposits, loan interest and principal payments and prepayments, FHLB advances and proceeds from the sale of securities.

Sunwest Bank's liquid asset ratio (the sum of cash, investments available-for-sale, excluding pledged amounts, and Federal funds sold, divided by total assets) was 46.04% at March 31, 2006. At March 31, 2006, Sunwest Bank had available borrowing capacity totaling \$106 million. Management believes the Bank has sufficient liquidity to support its operations.

## Capital Resources and Dividends

The following table reflects Sunwest Bank's actual levels of regulatory capital as of March 31, 2006 and the applicable minimum regulatory capital requirements as well as the regulatory capital requirements that apply to be deemed "Well Capitalized" pursuant to the prompt corrective action requirements (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>As of March 31, 2006</u>						
Tier 1 leverage ratio..... \$	32,777	10.92%	\$ 12,011	4.00%	\$ 15,014	5.00%
Tier 1 risk-based capital ratio .	32,777	15.52	8,447	4.00	12,671	6.00
Total risk based capital ratio...	35,308	16.72	16,894	8.00	21,118	10.00
<u>As of December 31, 2005</u>						
Tier 1 leverage ratio..... \$	32,189	10.73%	\$ 12,003	4.00%	\$ 15,004	5.00%
Tier 1 risk-based capital ratio .	32,189	15.62	8,242	4.00	12,363	6.00
Total risk based capital ratio...	34,720	16.85	16,484	8.00	20,605	10.00

Sunwest Bank is classified as a "Well Capitalized" depository institution for regulatory purposes.

We have no material commitments for capital expenditures as of March 31, 2006. Sunwest Bank has not paid dividends in 2006 and has no plans to pay dividends.

## Off-Balance Sheet Arrangements

The following table provides the off-balance sheet arrangements of Sunwest Bank as of March 31, 2006 (dollars in thousands):

Commitments to fund loans	\$	74,603
Commitments under letters of credit		1,187

Of the commitments to fund loans, \$7.1 million are for construction loans. The remainder relates primarily to revolving lines of credit or other commercial loans, and many of these commitments are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements.

**ITEM 3. *Controls and Procedures***

- (a) Based on their evaluation of Sunwest Bank's disclosure controls and procedures as of the end of the period covered by this report on Form 10-QSB, Sunwest Bank's principal executive officer and principal financial officer have concluded that Sunwest Bank's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of March 31, 2006 are effective.
  
- (b) There has been no change in Sunwest Bank's internal controls over financial reporting that occurred during the last fiscal quarter that has materially affected or is reasonably likely to materially affect Sunwest Bank's internal controls over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

None

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

### Item 3. Defaults Upon Senior Securities

None

### Item 4. Submission of Matters to a Vote of Security Holders

None

### Item 5. Other Information

None

### Item 6. Exhibits

<u>Number</u>	<u>Description</u>
31.1	Section 302 Certification for Glenn E. Gray
31.2	Section 302 Certification for John Michel
32.1	Section 906 Certification for Glenn E. Gray and John M. Michel

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized,

SUNWEST BANK

Registrant

Date: May 1, 2006

/s/ Glenn E. Gray

Glenn E. Gray, Chief Executive Officer

Date: May 1, 2006

/s/ John Michel

John M. Michel, Chief Financial Officer