

SUMMIT FINANCIAL GROUP INC  
Form 10-Q  
November 15, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10 – Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010.

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934 For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 0-16587

Summit Financial Group, Inc.  
(Exact name of registrant as specified in its charter)

West Virginia  
(State or other jurisdiction of  
incorporation or organization)

55-0672148  
(IRS Employer  
Identification No.)

300 North Main Street  
Moorefield, West Virginia 26836  
(Address of principal executive offices) (Zip Code)

(304) 530-1000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer’s classes of Common Stock as of the latest practicable date.

Common Stock, \$2.50 par value  
7,425,472 shares outstanding as of November 15, 2010

Summit Financial Group, Inc. and Subsidiaries  
Table of Contents

	Page	
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated balance sheets September 30, 2010 (unaudited), December 31, 2009, and September 30, 2009 (unaudited)	4
	Consolidated statements of income for the three months and nine months ended September 30, 2010 and 2009 (unaudited)	5
	Consolidated statements of shareholders' equity for the nine months ended September 30, 2010 and 2009 (unaudited)	6
	Consolidated statements of cash flows for the nine months ended September 30, 2010 and 2009 (unaudited)	7-8
	Notes to consolidated financial statements (unaudited)	9-32
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	33-48
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	49
Item 4.	Controls and Procedures	50

Summit Financial Group, Inc. and Subsidiaries  
Table of Contents

## PART II. OTHER INFORMATION

Item 1.	Legal Proceedings	51
Item 1A.	Risk Factors	51
Item 2.	Changes in Securities and Use of Proceeds	None
Item 3.	Defaults upon Senior Securities	None
Item 4.	Removed and Reserved	
Item 5.	Other Information	None
Item 6.	Exhibits	
	Exhibits	
	Exhibit 11	Statement re: Computation of Earnings per Share – Information contained in Note 4 to the Consolidated Financial Statements on page 15 of this Quarterly Report is incorporated herein by reference.
	Exhibit 31.1	Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer
	Exhibit 31.2	Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer
	Exhibit 32.1	Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer
	Exhibit 32.2	Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer
SIGNATURES		52

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Summit Financial Group, Inc. and Subsidiaries  
Consolidated Balance Sheets (unaudited)

	September 30, 2010 (unaudited)	December 31, 2009 (*)	September 30, 2009 (unaudited)
Dollars in thousands			
<b>ASSETS</b>			
Cash and due from banks	\$4,598	\$6,813	\$4,415
Interest bearing deposits with other banks	40,691	34,247	6,195
Securities available for sale	267,856	271,654	285,156
Other investments	23,988	24,008	24,002
Loans held for sale, net	1,298	1	251
Loans, net	1,018,169	1,137,336	1,156,432
Property held for sale	68,353	40,293	31,193
Premises and equipment, net	23,402	24,234	23,891
Accrued interest receivable	5,962	6,323	6,666
Intangible assets	9,090	9,353	9,441
Other assets	33,005	30,363	30,151
Total assets	\$1,496,412	\$1,584,625	\$1,577,793
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Deposits			
Non interest bearing	\$76,362	\$74,119	\$68,929
Interest bearing	953,670	943,219	901,093
Total deposits	1,030,032	1,017,338	970,022
Short-term borrowings	1,610	49,739	73,733
Long-term borrowings	329,648	381,492	396,648
Subordinated debentures	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	8,499	9,007	9,064
Total liabilities	1,406,178	1,493,965	1,485,856
<b>Commitments and Contingencies</b>			
<b>Shareholders' Equity</b>			
Preferred stock and related surplus - authorized 250,000 shares;			
Series 2009, 8% Non-cumulative convertible preferred stock, par value \$1.00; issued 3,710 shares	3,519	3,519	3,558
Common stock and related surplus - authorized 20,000,000 shares;			
\$2.50 par value; issued and outstanding 7,425,472 shares	24,508	24,508	24,508
Retained earnings	60,365	63,474	63,982
Accumulated other comprehensive income (loss)	1,842	(841 )	(111 )
Total shareholders' equity	90,234	90,660	91,937
Total liabilities and shareholders' equity	\$1,496,412	\$1,584,625	\$1,577,793

(\* ) - December 31, 2009 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated Financial Statements

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Summit Financial Group, Inc. and Subsidiaries  
Consolidated Statements of Income (unaudited)

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	30,	30,	30,	30,
Dollars in thousands, except per share amounts	2010	2009	2010	2009
<b>Interest income</b>				
<b>Interest and fees on loans</b>				
Taxable	\$16,161	\$17,950	\$49,651	\$54,033
Tax-exempt	78	111	242	331
<b>Interest and dividends on securities</b>				
Taxable	2,874	3,808	9,153	12,226
Tax-exempt	434	543	1,340	1,572
Interest on interest bearing deposits with other banks	7	5	21	6
Total interest income	19,554	22,417	60,407	68,168
<b>Interest expense</b>				
Interest on deposits	5,160	6,094	16,037	19,073
Interest on short-term borrowings	2	129	79	487
Interest on long-term borrowings and subordinated debentures	4,844	5,298	14,576	15,270
Total interest expense	10,006	11,521	30,692	34,830
Net interest income	9,548	10,896	29,715	33,338
Provision for loan losses	4,500	4,000	18,350	13,500
Net interest income after provision for loan losses	5,048	6,896	11,365	19,838
<b>Other income</b>				
Insurance commissions	1,227	1,254	3,659	3,881
Service fees	763	859	2,298	2,452
Realized securities gains (losses)	67	428	1,587	723
Gain (loss) on sale of assets	(84)	9	111	(115)
Writedown of OREO	-	-	(2,194)	-
Other	422	282	1,161	973
Total other-than-temporary impairment loss on securities	(184)	-	(638)	(5,434)
Portion of loss recognized in other comprehensive income	75	-	500	451
Net impairment loss recognized in earnings	(109)	-	(138)	(4,983)
Total other income	2,286	2,832	6,484	2,931
<b>Other expense</b>				
Salaries, commissions, and employee benefits	3,866	3,862	11,428	12,449
Net occupancy expense	498	484	1,529	1,548
Equipment expense	620	654	1,883	1,990
Supplies	117	114	360	315
Professional fees	223	330	759	1,067
Amortization of intangibles	88	88	263	263
FDIC premiums	715	660	2,165	2,288
OREO expense	671	139	1,147	295
Other	1,262	1,536	3,791	4,112
Total other expense	8,060	7,867	23,325	24,327
Income (loss) before income taxes	(726)	1,861	(5,476)	(1,558)

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Income tax expense (benefit)	(598 )	458	(2,591 )	(1,276 )
Net Income (loss)	(128 )	1,403	(2,885 )	(282 )
Dividends on preferred shares	74	-	223	-
Net Income (loss) applicable to common shares	\$(202 )	\$1,403	\$(3,108 )	\$(282 )
Basic earnings per common share	\$(0.03 )	\$0.19	\$(0.42 )	\$(0.04 )
Diluted earnings per common share	\$(0.03 )	\$0.19	\$(0.42 )	\$(0.04 )

See Notes to Consolidated Financial Statements



Summit Financial Group, Inc. and Subsidiaries  
Consolidated Statements of Shareholders' Equity (unaudited)

Dollars in thousands, except per share amounts	Common Stock and Related Surplus	Preferred Stock and Related Surplus	Retained Earnings*	Accumulated Other Compre- hensive Income (Loss)	Total Share- holders' Equity*
Balance, December 31, 2009	\$24,508	\$3,519	\$63,474	\$ (841 )	\$90,660
Nine Months Ended September 30, 2010					
Comprehensive income:					
Net income (loss)	-	-	(2,885 )	-	(2,885 )
Other comprehensive income:					
Non-credit related other-than-temporary impairment on available for sale debt securities of \$500, net of deferred taxes of \$190	-	-	-	(310 )	(310 )
Net unrealized gain on available for sale debt securities of \$4,827 net of deferred taxes of \$1,834 and reclassification adjustment for net realized gains included in net income of \$1,587	-	-	-	2,993	2,993
Total comprehensive income					(202 )
Exercise of stock options	-	-	-	-	-
Stock compensation expense	-	-	-	-	-
Preferred stock cash dividends declared (\$40.00 per share)	-	-	(223 )	-	(223 )
Balance, September 30, 2010	\$24,508	\$3,519	\$60,365	\$ 1,842	\$90,234
* may not add due to rounding					
Balance, December 31, 2008	\$24,453	\$-	\$64,709	\$ (1,918 )	\$87,244
Nine Months Ended September 30, 2009					
Comprehensive income:					
Net income (loss)	-	-	(282 )	-	(282 )
Other comprehensive income:					
Non-credit related other-than-temporary impairment on available for sale debt securities, net of deferred taxes of \$153	-	-	-	(250 )	(250 )
Net unrealized gain on available for sale debt securities of \$1,334 net of deferred taxes of \$1,258 and reclassification adjustment for net realized gains included in net income of \$723	-	-	-	2,057	2,057

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Total comprehensive income					1,525
Exercise of stock options	55	-	-	-	55
Stock compensation expense	-	-	-	-	-
Issuance of 3,710 shares preferred stock	-	3,558	-	-	3,558
Cash dividends declared of \$0.06 per common share	-	-	(445 )	-	(445 )
Balance, September 30, 2009	\$24,508	\$3,558	\$63,982	\$ (111 )	\$91,937

See Notes to Consolidated Financial Statements

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Summit Financial Group, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows (unaudited)

	Nine Months Ended	
	September 30, 2010	September 30, 2009
Dollars in thousands		
<b>Cash Flows from Operating Activities</b>		
Net (loss)	\$(2,885 )	\$(282 )
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	1,194	1,190
Provision for loan losses	18,350	13,500
Deferred income tax (benefit)	(1,575 )	(1,959 )
Loans originated for sale	(7,453 )	(14,990 )
Proceeds from loans sold	6,156	15,742
(Gain) on sales of loans held for sale	-	(26 )
Securities (gains)	(1,587 )	(723 )
Writedown of equity investment	-	215
Other-than-temporary impairment of debt securities	138	4,768
(Gain) loss on sale of assets	(121 )	110
Writedown of OREO	2,194	
Accretion of securities premiums, net	(762 )	(2,137 )
Amortization of goodwill and purchase accounting adjustments, net	272	272
Decrease in accrued interest receivable	360	550
(Increase) in other assets	(4,306 )	(4,906 )
Increase (decrease) in other liabilities	(507 )	479
<b>Net cash provided by operating activities</b>	<b>9,468</b>	<b>11,803</b>
<b>Cash Flows from Investing Activities</b>		
Net (increase) in interest bearing deposits with other banks	(6,444 )	(6,087 )
Proceeds from maturities and calls of securities available for sale	46,860	15,704
Proceeds from sales of securities available for sale	32,849	18,479
Principal payments received on securities available for sale	40,134	58,648
Purchases of securities available for sale	(109,508 )	(49,592 )
Purchases of other investments	(2,998 )	(983 )
Proceeds from maturities and calls of other investments	3,000	-
Redemption of Federal Home Loan Bank Stock	19	-
Net decrease in Federal funds sold	-	2
Net (loans made) principal payments received on loans	54,854	(2,601 )
Purchases of premises and equipment	(364 )	(2,648 )
Proceeds from sales of other repossessed assets & property held for sale	17,417	1,697
<b>Net cash provided by (used in) investing activities</b>	<b>75,819</b>	<b>32,619</b>
<b>Cash Flows from Financing Activities</b>		
Net increase (decrease) in demand deposit, NOW and savings accounts	(86 )	50,892
Net increase (decrease) in time deposits	12,780	(46,720 )

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Net (decrease) in short-term borrowings	(48,129 )	(79,367 )
Proceeds from long-term borrowings	-	82,656
Repayment of long-term borrowings	(51,844 )	(68,755 )
Proceeds from issuance of subordinated debentures	-	6,763
Exercise of stock options	-	55
Dividends paid on common stock	-	(445 )
Dividends paid on preferred stock	(223 )	-
Proceeds from issuance of preferred stock	-	3,558
Net cash provided by (used in) financing activities	(87,502 )	(51,363 )
Increase (decrease) in cash and due from banks	(2,215 )	(6,941 )
Cash and due from banks:		
Beginning	6,813	11,356
Ending	\$4,598	\$4,415

(Continued)

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows (unaudited)

Dollars in thousands	Nine Months Ended	
	September 30, 2010	September 30, 2009
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	\$31,274	\$35,173
Income taxes	\$-	\$1,395
Supplemental Schedule of Noncash Investing and Financing Activities		
Other assets acquired in settlement of loans	\$45,962	\$24,826

See Notes to Consolidated Financial Statements

8

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Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

NOTE 1. BASIS OF PRESENTATION

We, Summit Financial Group, Inc. and subsidiaries, prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for annual year end financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature.

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us 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 materially from these estimates. For the third quarter of 2010, we evaluated subsequent events through November 15, 2010, the filing date of this report.

The results of operations for the quarter and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2009 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2009 and September 30, 2009, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures About Fair Value Measurements, requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements.

ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) company's should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required for us beginning January 1, 2011. The remaining disclosure requirements and clarifications made by ASU 2010-06 became effective for us on January 1, 2010. See Note 3 – Fair Value Measurements.

ASU No. 2010-11, Derivatives and Hedging (Topic 815) - Scope Exception Related to Embedded Credit Derivatives clarifies that the only form of an embedded credit derivative that is exempt from embedded derivative bifurcation requirements are those that relate to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. The provisions of ASU 2010-11 was effective for us on July 1, 2010 and did not have a significant impact on our financial statements.

ASU No. 2010-20, Receivables (Topic 310) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 will be effective for our financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period will be required for our financial statements that include periods beginning on or after January 1, 2011.



Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

NOTE 3. FAIR VALUE MEASUREMENTS

ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Accordingly, securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record other assets at fair value on a nonrecurring basis, such as loans held for sale, and impaired loans held for investment. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

**Available-for-Sale Securities:** Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities.

**Loans Held for Sale:** Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, we classify loans subject to nonrecurring fair value adjustments as Level 2.

**Loans:** We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, Accounting by Creditors for Impairment of a Loan. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2010, substantially all of the total impaired loans

were evaluated based on the fair value of the collateral. In accordance with ASC Topic 310, impaired loans where an allowance is established based on the fair value of collateral requires classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When a current appraised value is not available and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

When a collateral-dependent loan is identified as impaired, management immediately begins the process of evaluating the estimated fair value of the underlying collateral to determine if a related specific allowance for loan losses or charge-off is necessary. Current appraisals are ordered once a loan is deemed impaired if the existing appraisal is more than twelve months old, or more frequently if there is known deterioration in value. For recently identified impaired loans, a current appraisal may not be available at the financial statement date. Until the current appraisal is obtained, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the loan's underlying collateral since the date of the original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar collateral within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends. When a new appraisal is received (which generally are received within 3 months of a loan being identified as impaired), management then re-evaluates the fair value of the collateral and adjusts any specific allocated allowance for loan losses, as appropriate. In addition, management also assigns a discount of 7–10% for the estimated costs to sell the collateral. As of September 30, 2010, the total fair value of our collateral-dependent impaired loans which had a related specific allowance or prior charge-off was \$2,455,000 less than the related appraised values of the underlying collateral for such loans.

Other Real Estate Owned ("OREO"): OREO consists of real estate acquired in foreclosure or other settlement of loans. Such assets are carried on the balance sheet at the lower of the investment in the real estate or its fair value less estimated selling costs. The fair value of OREO is determined on a nonrecurring basis generally utilizing current appraisals performed by an independent, licensed appraiser applying an income or market value approach using observable market data (Level 2). Updated appraisals of OREO are generally obtained if the existing appraisal is more than 18 months old or more frequently if there is a known deterioration in value. However, if a current appraisal is not available, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the real estate since the date of its original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar property within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends (Level 3). Upon foreclosure, any fair value adjustment is charged against the allowance for loan losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest income in the consolidated statements of income.

Derivative Assets and Liabilities: Substantially all derivative instruments held or issued by us for risk management or customer-initiated activities are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, we measure fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. We classify derivative instruments held or issued for risk management or customer-initiated activities as Level 2. Examples of Level 2 derivatives are interest rate swaps.

#### Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets measured at fair value on a recurring basis.

In thousands	Balance at September 30, 2010	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities	\$ 46,937	\$ -	\$ 46,937	\$ -

U.S. Government sponsored agencies				
Mortgage backed securities:				
Government sponsored agencies	108,887	-	108,887	-
Nongovernment sponsored agencies	62,460	-	62,460	-
State and political subdivisions	8,628	-	8,628	-
Corporate debt securities	983	-	983	-
Other equity securities	77	-	77	-
Tax-exempt state and political subdivisions	39,884	-	39,884	-
Total available for sale securities	\$ 267,856	\$ -	\$ 267,856	\$ -

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

In thousands	Balance at December 31, 2009	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	\$ 54,961	\$ -	\$ 54,961	\$ -
Mortgage backed securities:				
Government sponsored agencies	100,036	-	100,036	-
Nongovernment sponsored agencies				
State and political subdivisions	69,797	-	69,797	-
Corporate debt securities	3,792	-	3,792	-
Other equity securities	356	-	356	-
Tax-exempt state and political subdivisions	77	-	77	-
Total available for sale securities	\$ 271,654	\$ -	\$ 271,654	\$ -

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended September 30, 2010.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

In thousands	Total at Sept. 30, 2010	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 1,298	\$ -	\$ 1,298	\$ -
Impaired loans				
Commercial	\$ 943	\$ -	\$ 825	\$ 118
Commercial real estate	16,003	-	13,500	2,503
Construction and development	9,413	-	9,258	155
Residential real estate	20,977	-	14,973	6,004
Total impaired loans	\$ 47,336	\$ -	\$ 38,556	\$ 8,780
OREO	\$ 68,353	\$ -	\$ 64,663	\$ 3,690



Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

In thousands	Total at December 31, 2009	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 1	\$ -	\$ 1	\$ -
<b>Impaired loans</b>				
Commercial	\$ 104	\$ -	\$ -	\$ 104
Commercial real estate	48,057	-	30,585	17,472
Construction and development	25,621	-	20,717	4,904
Residential real estate	702	-	702	-
Total impaired loans	\$ 74,484	\$ -	\$ 52,004	\$ 22,480
OREO	\$ 40,293	\$ -	\$ 38,788	\$ 1,505

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, had a carrying amount at September 30, 2010 of \$55,554,000, with a valuation allowance of \$8,218,000, resulting in an additional provision for loan losses of \$5,736,000 for the nine months ended September 30, 2010.

ASC Topic 825, Financial Instruments, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The following summarizes the methods and significant assumptions we used in estimating our fair value disclosures for financial instruments.

Cash and due from banks: The carrying values of cash and due from banks approximate their estimated fair value.

Interest bearing deposits with other banks: The fair values of interest bearing deposits with other banks are estimated by discounting scheduled future receipts of principal and interest at the current rates offered on similar instruments with similar remaining maturities.

Federal funds sold: The carrying values of Federal funds sold approximate their estimated fair values.

Securities: Estimated fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

Loans held for sale: The carrying values of loans held for sale approximate their estimated fair values.

Loans: The estimated fair values for loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality. No prepayments of principal are assumed.

Accrued interest receivable and payable: The carrying values of accrued interest receivable and payable approximate their estimated fair values.

Deposits: The estimated fair values of demand deposits (i.e. non-interest bearing checking, NOW, money market and savings accounts) and other variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated using a discounted cash flow methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of long-term relationships with depositors is not considered in estimating the fair values disclosed.

Short-term borrowings: The carrying values of short-term borrowings approximate their estimated fair values.

Long-term borrowings: The fair values of long-term borrowings are estimated by discounting scheduled future payments of principal and interest at current rates available on borrowings with similar terms.



Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Subordinated debentures: The carrying values of subordinated debentures approximate their estimated fair values.

Subordinated debentures owed to unconsolidated subsidiary trusts: The carrying values of subordinated debentures owed to unconsolidated subsidiary trusts approximate their estimated fair values.

Off-balance sheet instruments: The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit standing of the counter parties. The amounts of fees currently charged on commitments and standby letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values are not shown below.

The carrying values and estimated fair values of our financial instruments are summarized below:

In thousands	September 30, 2010		December 31, 2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial assets</b>				
Cash and due from banks	\$ 4,598	\$ 4,598	\$ 6,813	\$ 6,813
Interest bearing deposits with				
other banks	40,691	40,691	34,247	34,247
Securities available for sale	267,856	267,856	271,654	271,654
Other investments	23,988	23,988	24,008	24,008
Loans held for sale, net	1,298	1,298	1	1
Loans, net	1,018,169	1,021,583	1,137,336	1,152,837
Accrued interest receivable	5,962	5,962	6,323	6,323
	\$ 1,362,562	\$ 1,365,976	\$ 1,480,382	\$ 1,495,883
<b>Financial liabilities</b>				
Deposits	\$ 1,030,032	\$ 1,100,475	\$ 1,017,338	\$ 1,087,212
Short-term borrowings	1,610	1,610	49,739	49,739
Long-term borrowings	329,648	354,528	381,492	395,375
Subordinated debentures	16,800	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589	19,589
Accrued interest payable	3,564	3,564	4,146	4,146
	\$ 1,401,243	\$ 1,496,566	\$ 1,489,104	\$ 1,572,861

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

## NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

Dollars in thousands, except per share amounts	For the Three Months Ended September 30,						
	2010	Common			2009	Common	
	Income	Shares	Per	Income	Shares	Per	
	(Numerator)	(Denominator)	Share	(Numerator)	(Denominator)	Share	
Net income	\$ (128 )			\$ 1,403			
Less preferred stock dividends	(74 )			-			
Basic EPS	\$ (202 )	7,425,472	\$ (0.03 )	\$ 1,403	7,425,472	\$ 0.19	
Effect of dilutive securities:							
Stock options	-	2,483		-	7,072		
Convertible preferred stock	-	-		-	7,332		
Diluted EPS	\$ (202 )	7,427,955	\$ (0.03 )	\$ 1,403	7,439,876	\$ 0.19	

Dollars in thousands, except per share amounts	For the Nine Months Ended September 30,						
	2010	Common			2009	Common	
	Income	Shares	Per	Income	Shares	Per	
	(Numerator)	(Denominator)	Share	(Numerator)	(Denominator)	Share	
Net income	\$ (2,885 )			\$ (282 )			
Less preferred stock dividends	(223 )			-			
Basic EPS	\$ (3,108 )	7,425,472	\$ (0.42 )	\$ (282 )	7,420,271	\$ (0.04 )	
Effect of dilutive securities:							

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Stock options	-	950	-	13,626		
Convertible preferred stock	-	-	-	2,471		
Diluted EPS	\$ (3,108 )	7,426,422	\$ (0.42 )	\$ (282 )	7,436,368	\$ (0.04 )

Stock option grants and the conversion of preferred stock are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options at September 30, 2010 and 2009 totaled 312,180 shares and 265,980 shares, respectively. Our anti-dilutive convertible preferred shares totaled 674,545 shares at September 30, 2010 and 2009.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

## NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at September 30, 2010, December 31, 2009, and September 30, 2009 are summarized as follows:

In thousands	Amortized	September 30, 2010		Estimated
Available for Sale	Cost	Unrealized	Losses	Fair Value
Taxable debt securities:				
U. S. Government agencies				
and corporations	\$ 46,008	\$ 944	\$ 15	\$ 46,937
Residential mortgage-backed securities:				
Government-sponsored agencies	104,419	4,553	85	108,887
Nongovernment-sponsored agencies	66,272	1,212	5,024	62,460
State and political subdivisions	8,561	72	5	8,628
Corporate debt securities	999	-	16	983
Total taxable debt securities	226,259	6,781	5,145	227,895
Tax-exempt debt securities:				
State and political subdivisions	38,547	1,423	86	39,884
Total tax-exempt debt securities	38,547	1,423	86	39,884
Equity securities	77	-	-	77
Total available for sale securities	\$ 264,883	\$ 8,204	\$ 5,231	\$ 267,856

In thousands	Amortized	December 31, 2009		Estimated
Available for Sale	Cost	Unrealized	Losses	Fair Value
Taxable debt securities:				
U. S. Government agencies				
and corporations	\$ 54,850	\$ 693	\$ 582	\$ 54,961
Residential mortgage-backed securities:				
Government-sponsored agencies	95,939	4,189	92	100,036
Nongovernment-sponsored agencies	75,546	662	6,411	69,797
State and political subdivisions	3,760	37	5	3,792
Corporate debt securities	350	6	-	356

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Total taxable debt securities	230,445	5,587	7,090	228,942
Tax-exempt debt securities:				
State and political subdivisions	42,486	570	421	42,635
Total tax-exempt debt securities	42,486	570	421	42,635
Equity securities	77	-	-	77
Total available for sale securities	\$ 273,008	\$ 6,157	\$ 7,511	\$ 271,654

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

In thousands	Amortized Cost	September 30, 2009 Unrealized Gains      Losses		Estimated Fair Value
Available for Sale				
Taxable debt securities				
U. S. Government agencies and corporations	\$ 34,694	\$ 961	\$ 4	\$ 35,651
Residential mortgage-backed securities:				
Government-sponsored agencies	116,237	5,196	13	121,420
Nongovernment-sponsored entities	83,050	148	7,939	75,259
State and political subdivisions	3,760	42	4	3,798
Corporate debt securities	350	9	-	359
Total taxable debt securities	238,091	6,356	7,960	236,487
Tax-exempt debt securities				
State and political subdivisions	47,063	1,277	180	48,160
Total tax-exempt debt securities	47,063	1,277	180	48,160
Equity securities	179	330	-	509
Total available for sale securities	\$ 285,333	\$ 7,963	\$ 8,140	\$ 285,156

The maturities, amortized cost and estimated fair values of securities at September 30, 2010, are summarized as follows:

In thousands	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 64,267	\$ 65,409
Due from one to five years	99,559	100,491
Due from five to ten years	39,127	38,637
Due after ten years	61,853	63,242
Equity securities	77	77
	\$ 264,883	\$ 267,856

The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the nine months ended September 30, 2010 are as follows:

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In thousands	Sales	Proceeds from Calls and Maturities	Principal Payments	Gains	Gross realized Losses
Securities available for sale	\$ 32,849	\$ 46,860	\$ 40,134	\$ 1,594	\$ 7

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

During the three months and nine months ended September 30, 2010 and 2009, we recorded other-than-temporary impairment losses on securities as follows:

In thousands	Three Months Ended			Nine Months Ended		
	Residential MBS Nongovernment	Equity Securities	Total	Residential MBS Nongovernment	Equity Securities	Total
September 30, 2010						
Total other-than-temporary impairment losses	\$(184 )	\$-	\$(184 )	\$(638 )	\$-	\$(638 )
Portion of loss recognized in other comprehensive income	75	-	75	500	-	500
Net impairment losses recognized in earnings	\$(109 )	\$-	\$(109 )	\$(138 )	\$-	\$(138 )
September 30, 2009						
Total other-than-temporary impairment losses	\$-	\$-	\$-	\$(5,219 )	\$(215 )	\$(5,434 )
Portion of loss recognized in other comprehensive income	-	-	-	451	-	451
Net impairment losses recognized in earnings	\$-	\$-	\$-	\$(4,768 )	\$(215 )	\$(4,983 )

Activity related to the credit component recognized on debt securities available for sale for which a portion of other-than-temporary impairment was recognized in other comprehensive income for the three months and nine months ended September 30, 2010 is as follows:

In thousands	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Beginning Balance	\$ (2,951 )	\$ (2,922 )
Additions for the credit component on debt securities in which other-than-temporary impairment was not previously	(109 )	(138 )



recognized

Securities sold during the period	-	-
Ending Balance	\$ (3,060 )	\$ (3,060 )

At September 30, 2010, our debt securities with other-than-temporary impairment in which only the amount of loss related to credit was recognized in earnings consisted solely of residential mortgage-backed securities issued by nongovernment-sponsored entities. We utilize third party vendors to estimate the portion of loss attributable to credit using a discounted cash flow models. The vendors estimate cash flows of the underlying collateral of each mortgage-backed security using models that incorporate their best estimates of current key assumptions, such as default rates, loss severity and prepayment rates. Assumptions utilized vary widely from security to security, and are influenced by such factors as underlying loan interest rates, geographical location of underlying borrowers, collateral type and other borrower characteristics. Specific such assumptions utilized by our vendors in their valuation of our other-than-temporarily impaired residential mortgage-backed securities issued by nongovernment-sponsored entities were as follows at September 30, 2010:

	Weighted Average	Range Minimum Maximum	
Constant voluntary prepayment rates	9.7%	5.4%	14.4%
Constant default rates	11.4%	8.2%	13.2%
Loss severities	51.5%	51.0%	53.0%

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Our vendors performing these valuations also analyze the structure of each mortgage-backed instrument in order to determine how the estimated cash flows of the underlying collateral will be distributed to each security issued from the structure. Expected principal and interest cash flows on the impaired debt securities are discounted predominantly using unobservable discount rates which the vendors assume that market participants would utilize in pricing the specific security. Based on the discounted expected cash flows derived from our vendor's models, we expect to recover the remaining unrealized losses on residential mortgage-backed securities issued by nongovernment sponsored entities.

Provided below is a summary of securities available for sale which were in an unrealized loss position at September 30, 2010 and December 31, 2009, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

In thousands	Less than 12 months		September 30, 2010 12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$1,154	\$(14 )	\$131	\$(1 )	\$1,285	\$(15 )
Residential mortgage-backed securities:						
Government-sponsored agencies	12,314	(85 )	-	-	12,314	(85 )
Nongovernment-sponsored entities	13,254	(944 )	18,251	(4,005 )	31,505	(4,949 )
State and political subdivisions	1,021	(1 )	386	(4 )	1,407	(5 )
Corporate debt securities	982	(16 )	-	-	982	(16 )
Tax-exempt debt securities						
State and political subdivisions	-	-	1,236	(86 )	1,236	(86 )
Total temporarily impaired securities	28,725	(1,060 )	20,004	(4,096 )	48,729	(5,156 )
Other-than-temporarily impaired securities						
Taxable debt securities						
Residential mortgage-backed securities:						
Nongovernment-sponsored entities	436	(53 )	956	(22 )	1,392	(75 )
Total other-than-temporarily impaired securities	436	(53 )	956	(22 )	1,392	(75 )
Total	\$29,161	\$(1,113 )	\$20,960	\$(4,118 )	\$50,121	\$(5,231 )



Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

In thousands	Less than 12 months		December 31, 2009 12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$26,607	\$(581 )	\$138	\$(1 )	\$26,745	\$(582 )
Residential mortgage-backed securities:						
Government-sponsored agencies	9,612	(91 )	68	(1 )	9,680	(92 )
Nongovernment-sponsored entities	24,500	(1,530 )	21,485	(4,637 )	45,985	(6,167 )
Tax-exempt debt securities						
State and political subdivisions	12,100	(138 )	3,748	(288 )	15,848	(426 )
Total temporarily impaired securities	72,819	(2,340 )	25,439	(4,927 )	98,258	(7,267 )
Other-than-temporarily impaired securities						
Taxable debt securities						
Residential mortgage-backed securities:						
Nongovernment-sponsored entities	-	-	1,670	(244 )	1,670	(244 )
Total other-than-temporarily impaired securities	-	-	1,670	(244 )	1,670	(244 )
Total	\$72,819	\$(2,340 )	\$27,109	\$(5,171 )	\$99,928	\$(7,511 )

We held 42 available for sale securities, including debt securities with other-than-temporary impairment in which a portion of the impairment remains in other comprehensive income, having an unrealized loss at September 30, 2010. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no additional other-than-temporary impairment charge to earnings is warranted at this time.

At September 30, 2010, we had \$5 million in total unrealized losses related to residential mortgage-backed securities issued by nongovernment sponsored entities. We monitor the performance of the mortgages underlying these bonds. Although there has been some deterioration in their collateral performance, we primarily hold the senior tranches of each issue which provides protection against defaults. We attribute the unrealized loss on these mortgage-backed securities held largely to the current absence of liquidity in the markets for such securities and not to deterioration in credit quality. The mortgages in these asset pools have been made to borrowers with strong credit history and significant equity invested in their homes. Nonetheless, further weakening of economic fundamentals

coupled with significant increases in unemployment and substantial deterioration in the value of high end residential properties could extend distress to this borrower population. This could increase default rates and put additional pressure on property values. Should these conditions occur, the value of these securities could decline further and result in the recognition of additional other-than-temporary impairment charges recognized in earnings.

#### NOTE 6. LOANS

Loans are generally stated at the amount of unpaid principal, reduced by unearned discount and allowance for loan losses. Interest on loans is accrued daily on the outstanding balances. Loan origination fees and certain direct loan origination costs are deferred and amortized as adjustments of the related loan yield over its contractual life.

Generally, loans are placed on nonaccrual status when principal or interest is greater than 90 days past due based upon the loan's contractual terms. Interest is accrued daily on impaired loans unless the loan is placed on nonaccrual status. Impaired loans are placed on nonaccrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well-secured and in the process of collection. Interest on nonaccrual loans is recognized primarily using the cost-recovery method. Loans may be returned to accrual status when repayment is reasonably assured and there has been demonstrated performance under the terms of the loan or, if applicable, the terms of the restructured loans.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Commercial-related loans or portions thereof (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination is made on a case by case basis considering many factors, including the prioritization of our claim in bankruptcy, expectations of the workout/restructuring of the loan and valuation of the borrower's equity. We deem a loss confirmed when a loan or a portion of a loan is classified "loss" in accordance with bank regulatory classification guidelines, which state, "Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted".

Consumer-related loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), which ever is earlier. Residential mortgage loans are generally charged off to net realizable value no later than when the account becomes 180 days past due. Other consumer loans, if collateralized, are generally charged off to net realizable value at 120 days past due.

Loans are summarized as follows:

In thousands	September 30, 2010	December 31, 2009	September 30, 2009
Commercial	\$ 95,939	\$ 122,508	\$ 125,743
Commercial real estate	430,003	465,037	457,669
Construction and development	122,455	162,080	176,783
Residential real estate	360,142	372,867	376,439
Consumer	25,006	28,203	29,555
Other	5,227	5,652	6,087
Total loans	1,038,772	1,156,347	1,172,276
Less unearned income	1,734	2,011	1,996
Total loans net of unearned income	1,037,038	1,154,336	1,170,280
Less allowance for loan losses	18,869	17,000	13,848
Loans, net	\$ 1,018,169	\$ 1,137,336	\$ 1,156,432

The tables below set forth information about our impaired loans.

In thousands	September 30,		December 31, 2009
	2010	2009	
Impaired loans with an allowance	\$ 21,507	\$ 17,612	\$ 39,210
Impaired loans without an allowance	34,047	46,708	46,123
Impaired loans without an allowance as a result of a direct charge off	-	-	-
Total impaired loans	\$ 55,554	\$ 64,320	\$ 85,333

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Allowance for loan losses attributed to impaired loans	\$ 8,218	\$ 4,735	\$ 10,211
	Nine Months Ended Sept. 30,		Year Ended December 31,
In thousands	2010	2009	2009
Average balance of impaired loans	\$ 66,834	\$ 52,209	\$ 75,698
Interest income recognized on impaired loans	\$ 2,011	\$ 44	\$ 298

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Method Used to Measure Impairment of  
Impaired Loans  
In thousands

Loan Category	9/30/2010	12/31/2009	Method used to measure impairment
Commerical	\$ 1,306	\$ 301	Fair value of collateral
Commerical real estate	16,154	43,639	Fair value of collateral
	-	7,658	Discounted cash flow
Construction and development	15,014	31,091	Fair value of collateral
Residential real estate	22,808	2,005	Fair value of collateral
	272	639	Discounted cash flow
<b>Total</b>	<b>\$ 55,554</b>	<b>\$ 85,333</b>	

Included in impaired loans are troubled debt restructurings of \$23,944,000, \$5,259,000 and \$8,297,000 at September 30, 2010, September 30, 2009, and December 31, 2009, respectively.

NOTE 7. ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses for the nine month periods ended September 30, 2010 and 2009, and for the year ended December 31, 2009 is as follows:

In thousands	Nine Months Ended		Year Ended
	September 30,		December
	2010	2009	31, 2009
Balance, beginning of period	\$ 17,000	\$ 16,933	\$ 16,933
Losses:			
Commercial	406	343	479
Commercial real estate	8,289	459	469
Construction and development	5,436	15,339	16,946
Residential real estate	2,490	1,907	3,921



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Consumer	246	167	214
Other	123	180	231
Total	16,990	18,395	22,260
Recoveries:			
Commercial	30	14	129
Commercial real estate	6	12	23
Construction and development	184	1,594	1,615
Residential real estate	125	22	29
Consumer	76	71	90
Other	88	97	116
Total	509	1,810	2,002
Net losses	16,481	16,585	20,258
Provision for loan losses	18,350	13,500	20,325
Balance, end of period	\$ 18,869	\$ 13,848	\$ 17,000

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

## NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

The following tables present our goodwill by reporting unit at September 30, 2010 and other intangible assets by reporting unit at September 30, 2010 and December 31, 2009.

In thousands	Goodwill Activity		
	Community Banking	Insurance Services	Total
Balance, January 1, 2010	\$ 1,488	\$ 4,710	\$ 6,198
Acquired goodwill, net	-	-	-
Balance, September 30, 2010	\$ 1,488	\$ 4,710	\$ 6,198

In thousands	September 30, 2010			December 31, 2009		
	Community Banking	Insurance Services	Total	Community Banking	Insurance Services	Total
Unidentifiable intangible assets						
Gross carrying amount	\$ 2,267	\$ -	\$ 2,267	\$ 2,267	\$ -	\$ 2,267
Less: accumulated amortization	1,725	-	1,725	1,612	-	1,612
Net carrying amount	\$ 542	\$ -	\$ 542	\$ 655	\$ -	\$ 655
Identifiable intangible assets						
Gross carrying amount	\$ -	\$ 3,000	\$ 3,000	\$ -	\$ 3,000	\$ 3,000
Less: accumulated amortization	-	650	650	-	500	500
Net carrying amount	\$ -	\$ 2,350	\$ 2,350	\$ -	\$ 2,500	\$ 2,500

We recorded amortization expense of approximately \$263,000 for the nine months ended September 30, 2010 relative to our other intangible assets. Annual amortization is expected to be approximately \$351,000 for each of the years ending 2010 through 2012.

## NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of September 30, 2010 and 2009 and December 31, 2009:

In thousands	September 30, 2010	December 31, 2009	September 30, 2009
Interest bearing demand deposits	\$ 152,393	\$ 148,587	\$ 154,683
Savings deposits	182,284	188,419	115,767
Retail time deposits	375,953	364,399	363,406
Brokered time deposits	243,040	241,814	267,237
Total	\$ 953,670	\$ 943,219	\$ 901,093

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Brokered deposits represent certificates of deposit acquired through a third party. The following is a summary of the maturity distribution of all certificates of deposit in denominations of \$100,000 or more as of September 30, 2010:

Dollars in thousands	Amount	Percent
Three months or less	\$ 63,253	14.9 %
Three through six months	37,416	8.8 %
Six through twelve months	63,020	14.9 %
Over twelve months	260,323	61.4 %
Total	\$ 424,012	100.0 %

A summary of the scheduled maturities for all time deposits as of September 30, 2010 is as follows:

In thousands	
Three month period ending December 31, 2010	\$ 97,683
Year ending December 31, 2011	232,040
Year ending December 31, 2012	89,801
Year ending December 31, 2013	82,511
Year ending December 31, 2014	45,787
Thereafter	71,171
	\$ 618,993

NOTE 10. BORROWED FUNDS

Short-term borrowings: A summary of short-term borrowings is presented below:

In thousands	Nine Months Ended September 30, 2010		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at September 30	\$ -	\$ 657	\$ 953
	18,259	1,237	1,502

Average balance outstanding for  
the period

Maximum balance outstanding at any month end during period	45,000	1,787	3,617
Weighted average interest rate for the period	0.42 %	0.36 %	1.63 %
Weighted average interest rate for balances outstanding at September 30	0.00 %	0.25 %	0.25 %

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Dollars in thousands	Year Ended December 31, 2009		
	Short-term	Repurchase	Federal
	FHLB	Agreements	Funds
	Advances		Purchased and Lines of Credit
Balance at December 31	\$ 45,000	\$ 1,123	\$ 3,616
Average balance outstanding for the period	92,326	1,079	6,092
Maximum balance outstanding at any month end during period	184,825	2,433	9,663
Weighted average interest rate for the period	0.50 %	0.38 %	1.83 %
Weighted average interest rate for balances outstanding at December 31	0.32 %	0.49 %	3.01 %

Dollars in thousands	Nine Months Ended September 30, 2009		
	Short-term	Repurchase	Federal
	FHLB	Agreements	Funds
	Advances		Purchased and Lines of Credit
Balance at September 30	\$ 69,560	\$ 557	\$ 3,616
Average balance outstanding for the period	105,711	1,259	6,926
Maximum balance outstanding at any month end during period	184,825	2,433	9,663
Weighted average interest rate for the period	0.50 %	0.39 %	1.61 %
Weighted average interest rate for balances outstanding at September 30	0.54 %	0.34 %	3.01 %

Long-term borrowings: Our long-term borrowings of \$329,648,000, \$381,492,000 and \$396,648,000 at September 30, 2010, December 31, 2009, and September 30, 2009 respectively, consisted primarily of advances from the Federal Home Loan Bank (“FHLB”) and structured reverse repurchase agreements with two unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

Balance at  
Balance at September 30,

Dollars in thousands	2010	2009	December 31, 2009
Long-term FHLB advances	\$ 207,462	\$ 274,011	\$ 258,855
Long-term reverse repurchase agreements	110,000	110,000	110,000
Term loan	12,186	12,637	12,637
Total	\$ 329,648	\$ 396,648	\$ 381,492

The term loan represents a long-term borrowing with an unaffiliated banking institution which is secured by the common stock of our subsidiary bank, bears a variable interest rate of prime minus 50 basis points, and matures in 2017.

Our long term borrowings bear both fixed and variable rates and mature in varying amounts through the year 2019.

The average interest rate paid on long-term borrowings for the nine month period ended September 30, 2010 was 5.02% compared to 4.78% for the first nine months of 2009.

Subordinated debentures: We have subordinated debt which qualifies as Tier 2 regulatory capital totaling \$16.8 million at September 30, 2010, December 31, 2009, and September 30, 2009. During 2009, we issued \$6.8 million in subordinated debt, of which \$5 million was issued to an affiliate of a director of Summit. We also issued \$1.0 million and \$0.8 million to two unrelated parties. These three issuances bear an interest rate of 10 percent per annum, a term of 10 years, and are not prepayable by us within the first five years. During 2008, we issued \$10 million of subordinated debt to an unrelated institution, which bears a variable interest rate of 1 month LIBOR plus 275 basis points, a term of 7.5 years, and is not prepayable by us within the first two and one half years.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Subordinated debentures owed to unconsolidated subsidiary trusts: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the “capital securities”) for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the “debentures”). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled \$19,589,000 at September 30, 2010, December 31, 2009, and September 30, 2009.

In October 2002, we sponsored SFG Capital Trust I, in March 2004, we sponsored SFG Capital Trust II, and in December 2005, we sponsored SFG Capital Trust III, of which 100% of the common equity of each trust is owned by us. SFG Capital Trust I issued \$3,500,000 in capital securities and \$109,000 in common securities and invested the proceeds in \$3,609,000 of debentures. SFG Capital Trust II issued \$7,500,000 in capital securities and \$232,000 in common securities and invested the proceeds in \$7,732,000 of debentures. SFG Capital Trust III issued \$8,000,000 in capital securities and \$248,000 in common securities and invested the proceeds in \$8,248,000 of debentures. Distributions on the capital securities issued by the trusts are payable quarterly at a variable interest rate equal to 3 month LIBOR plus 345 basis points for SFG Capital Trust I, 3 month LIBOR plus 280 basis points for SFG Capital Trust II, and 3 month LIBOR plus 145 basis points for SFG Capital Trust III, and equals the interest rate earned on the debentures held by the trusts, and is recorded as interest expense by us. The capital securities are subject to mandatory redemption in whole or in part, upon repayment of the debentures. We have entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of the guarantee. The debentures of SFG Capital Trust I and SFG Capital Trust II are redeemable by us quarterly, and the debentures of SFG Capital Trust III are first redeemable by us in March 2011.

The capital securities held by SFG Capital Trust I, SFG Capital Trust II, and SFG Capital Trust III qualify as Tier 1 capital under Federal Reserve Board guidelines. In accordance with these Guidelines, trust preferred securities generally are limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital.

A summary of the maturities of all long-term borrowings and subordinated debentures for the next five years and thereafter is as follows:

In thousands	
Year Ending	
December 31,	Amount
2010	\$ 25,539
2011	35,395
2012	66,720
2013	41,885
2014	83,416
Thereafter	113,082
	\$ 366,037

#### NOTE 11. STOCK OPTION PLAN

The 2009 Officer Stock Option Plan was adopted by our shareholders in May 2009 and provides for the granting of stock options for up to 350,000 shares of common stock to our key officers. Each option granted under the Plan vests according to a schedule designated at the grant date and has a term of no more than 10 years following the



vesting date. Also, the option price per share was not to be less than the fair market value of our common stock on the date of grant. The 2009 Officer Stock Option Plan, which expires in May 2019, replaces the 1998 Officer Stock Option Plan (collectively the “Plans”) that expired in May 2008.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

The fair value of our employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Because our employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options at the time of grant. There were 8,000 options granted during the first nine months of 2010 and no option grants during the first nine months of 2009.

All compensation cost related to nonvested awards was previously recognized prior to January 1, 2009.

A summary of activity in our Plans during the first nine months of 2010 and 2009 is as follows:

	For the Nine Months Ended September 30,			
	2010		2009	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, January 1	309,180	\$ 18.42	335,730	\$ 18.36
Granted	8,000	3.92	-	-
Exercised	-	-	(8,000 )	5.36
Forfeited	-	-	(1,600 )	5.21
Outstanding, September 30	317,180	\$ 18.17	326,130	\$ 18.74

Other information regarding options outstanding and exercisable at September 30, 2010 is as follows:

Range of exercise price	# of shares	Options Outstanding			Options Exercisable	
		Wted. Avg. Remaining Contractual WAEP	Avg. Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of shares	Aggregate Intrinsic Value (in thousands)
\$2.54 - \$6.00	64,150	\$5.15	3.33	\$7.00	59,150	\$5.37
6.01 - 10.00	33,680	9.2	5.84	-	31,280	9.43
10.01 - 17.50	2,300	17.43	3.42	-	2,300	17.43
17.51 - 20.00	51,300	17.79	6.25	-	51,000	17.79

20.01 -						
25.93	165,750	25.15	5.03 -		165,750	25.15 -
	317,180	18.17		\$7.00	309,480	18.51 \$-

NOTE 12. COMMITMENTS AND CONTINGENCIES

Off-Balance Sheet Arrangements

We are a party to certain financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. The contract amounts of these instruments reflect the extent of involvement that we have in this class of financial instruments.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Many of our lending relationships contain both funded and unfunded elements. The funded portion is reflected on our balance sheet. The unfunded portion of these commitments is not recorded on our balance sheet until a draw is made under the loan facility. Since many of the commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements.

A summary of the total unfunded, or off-balance sheet, credit extension commitments follows:

In thousands	September 30, 2010
Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 43,813
Construction loans	19,489
Other loans	36,984
Standby letters of credit	2,735
Total	\$ 103,021

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if we deem necessary upon extension of credit, is based on our credit evaluation. Collateral held varies but may include accounts receivable, inventory, equipment or real estate.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments.

#### NOTE 13. REGULATORY MATTERS

We and our subsidiaries are subject to various regulatory capital requirements administered by the banking regulatory agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we and each of our subsidiaries must meet specific capital guidelines that involve quantitative measures of our and our subsidiaries' assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. We and each of our subsidiaries' capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). We believe, as of September 30, 2010, that we and each of our subsidiaries met all capital adequacy requirements to which they were subject.

The most recent notifications from the banking regulatory agencies categorized us and each of our subsidiaries as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, we and each of our subsidiaries must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below.

Our actual capital amounts and ratios as well as our subsidiary, Summit Community Bank's ("Summit Community") are presented in the following table.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

Dollars in thousands	Actual			Minimum Required Regulatory Capital			To be Well Capitalized under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
As of September 30, 2010									
Total Capital (to risk weighted assets)									
Summit	\$ 130,447	11.6 %		\$ 89,772	8.0 %		\$ 112,215	10.0 %	
Summit Community	137,266	12.2 %		89,802	8.0 %		112,252	10.0 %	
Tier I Capital (to risk weighted assets)									
Summit	\$ 99,267	8.8 %		44,886	4.0 %		67,329	6.0 %	
Summit Community	122,882	10.9 %		44,901	4.0 %		67,351	6.0 %	
Tier I Capital (to average assets)									
Summit	\$ 99,267	6.7 %		44,586	3.0 %		74,310	5.0 %	
Summit Community	122,882	8.3 %		44,562	3.0 %		74,270	5.0 %	
As of December 31, 2009									
Total Capital (to risk weighted assets)									
Summit	\$ 133,931	11.3 %		95,186	8.0 %		118,983	10.0 %	
Summit Community	134,874	11.4 %		94,666	8.0 %		118,332	10.0 %	
Tier I Capital (to risk weighted assets)									
Summit	102,232	8.6 %		47,593	4.0 %		71,390	6.0 %	
Summit Community	120,055	10.1 %		47,333	4.0 %		70,999	6.0 %	
Tier I Capital (to average assets)									
Summit	102,232	6.5 %		47,463	3.0 %		79,106	5.0 %	
Summit Community	120,055	7.6 %		47,257	3.0 %		78,762	5.0 %	

Summit Financial Group, Inc. (“Summit”) and its bank subsidiary, Summit Community Bank, Inc. (the “Bank”), have entered into informal Memoranda of Understanding (“MOU’s”) with their respective regulatory authorities. A memorandum of understanding is characterized by the regulatory authorities as an informal action that is not published or publicly available and that is used when circumstances warrant a milder form of action than a formal supervisory action, such as a formal written agreement or order. Among other things, under the MOU’s, Summit’s management team has agreed to:

- § The Bank achieving and maintaining a minimum Tier 1 leverage capital ratio of at least 8% and a total risk-based capital ratio of at least 11%;
- § The Bank providing 30 days prior notice of any declaration of intent to pay cash dividends to provide the Bank’s regulatory authorities an opportunity to object;
- § Summit suspending all cash dividends on its common stock until further notice. Dividends on all preferred stock, as well as interest payments on subordinated notes underlying Summit’s trust preferred securities, continue to be permissible; and,
- § Summit not incurring any additional debt, other than trade payables, without the prior written consent of the principal banking regulators.

Additional information regarding the MOU’s is included in Part I. Item 1A – Risk Factors on our Form 10-K for the year ended December 31, 2009.

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

On July 21 2010, sweeping financial regulatory reform legislation entitled the “Dodd-Frank Wall Street Reform and Consumer Protection Act” (the “Dodd-Frank Act”) was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including provisions that, among other things, will:

- § Centralize responsibility for consumer financial protection by creating a new agency, the Bureau of Consumer Financial Protection, responsible for implementing, examining and enforcing compliance with federal consumer financial laws.
- § Require the bank regulators to seek to make its capital requirements for all banks, countercyclical so that capital requirements increase in times of economic expansion and decrease in times of economic contraction.
- § Require financial holding companies to be well-capitalized and well-managed as of July 21, 2011. Bank holding companies and banks must also be both well-capitalized and well-managed in order to acquire banks located outside their home state.
- § Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminate the ceiling on the size of the Deposit Insurance Fund (DIF) and increase the floor of the size of the DIF, which generally will require an increase in the level of assessments for institutions with assets in excess of \$10 billion.
- § Impose comprehensive regulation of the over-the-counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself.
- § Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders that apply to all public companies, not just financial institutions.
- § Make permanent the \$250 thousand limit for federal deposit insurance and provide unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions.
- § Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.
- § Amend the Electronic Fund Transfer Act (EFTA) to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on our Company, our customers or the financial industry more generally. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits and interchange fees could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.





Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

## NOTE 14. SEGMENT INFORMATION

We operate two business segments: community banking and insurance services. These segments are primarily identified by the products or services offered. The community banking segment consists of our full service banks which offer customers traditional banking products and services through various delivery channels. The insurance services segment consists of three insurance agency offices that sell insurance products. The accounting policies discussed throughout the notes to the consolidated financial statements apply to each of our business segments.

Intersegment revenue and expense consists of management fees allocated to the bank and Summit Insurance Services, LLC for all centralized functions that are performed at the parent location including data processing, bookkeeping, accounting, treasury management, loan administration, loan review, compliance, risk management and internal auditing. We also provide overall direction in the areas of credit policy and administration, strategic planning, marketing, investment portfolio management and other financial and administrative services. Information for each of our segments is included below:

In thousands	Nine Months Ended September 30, 2010				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 31,165	\$ -	\$ (1,450 )	\$ -	\$ 29,715
Provision for loan losses	18,350	-	-	-	18,350
Net interest income after provision for loan losses	12,815	-	(1,450 )	-	11,365
Other income	2,513	3,628	1,178	(835 )	6,484
Other expenses	19,593	3,215	1,352	(835 )	23,325
Income (loss) before income taxes	(4,265 )	413	(1,624 )	-	(5,476 )
Income tax expense (benefit)	(2,154 )	165	(602 )	-	(2,591 )
Net income (loss)	(2,111 )	248	(1,022 )	-	(2,885 )
Dividends on preferred shares	-	-	223	-	223
Net income (loss) applicable to common shares	\$ (2,111 )	\$ 248	\$ (1,245 )	\$ -	\$ (3,108 )
Intersegment revenue (expense)	\$ (750 )	\$ (85 )	\$ 835	\$ -	\$ -
Average assets	\$ 1,568,104	\$ 6,946	\$ 141,026	\$ (190,448)	\$ 1,525,628

In thousands	Nine Months Ended September 30, 2009				
	Community Banking	Insurance Services	Parent	Eliminations	Total

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Net interest income	\$ 34,708	\$ -	\$ (1,371 )	\$ -	\$ 33,337
Provision for loan losses	13,500	-	-	-	13,500
Net interest income after provision for loan losses	21,208	-	(1,371 )	-	19,837
Other income	(670 )	3,816	4,762	(4,977 )	2,931
Other expenses	20,368	3,421	5,514	(4,977 )	24,326
Income (loss) before income taxes	170	395	(2,123 )	-	(1,558 )
Income tax expense (benefit)	(677 )	159	(758 )	-	(1,276 )
Net income (loss)	847	236	(1,365 )	-	(282 )
Dividends on preferred shares	-	-	-	-	-
Net income (loss) applicable to common shares	\$ 847	\$ 236	\$ (1,365 )	\$ -	\$ (282 )
Intersegment revenue (expense)	\$ (4,891 )	\$ (86 )	\$ 4,977	\$ -	\$ -
Average assets	\$ 1,590,554	\$ 7,434	\$ 135,839	\$ (134,886)	\$ 1,598,941

Summit Financial Group, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements (unaudited)

In thousands	Three Months Ended September 30, 2010				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 10,037	\$ -	\$ (489 )	\$ -	\$ 9,548
Provision for loan losses	4,500	-	-	-	4,500
Net interest income after provision for loan losses	5,537	-	(489 )	-	5,048
Other income	1,022	1,198	315	(249 )	2,286
Other expenses	6,848	1,092	369	(249 )	8,060
Income (loss) before income taxes	(289 )	106	(543 )	-	(726 )
Income tax expense (benefit)	(566 )	46	(78 )	-	(598 )
Net income (loss)	277	60	(465 )	-	(128 )
Dividends on preferred shares	-	-	74	-	74
Net income (loss) applicable to common shares	\$ 277	\$ 60	\$ (539 )	\$ -	\$ (202 )
Intersegment revenue (expense)	\$ (219 )	\$ (30 )	\$ 249	\$ -	\$ -
Average assets	\$ 1,561,074	\$ 6,732	\$ 139,673	\$ (213,157)	\$ 1,494,322

In thousands	Three Months Ended September 30, 2009				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 11,398	\$ -	\$ (503 )	\$ -	\$ 10,895
Provision for loan losses	4,000	-	-	-	4,000
Net interest income after provision for loan losses	7,398	-	(503 )	-	6,895
Other income	1,612	1,221	1,627	(1,627 )	2,833
Other expenses	6,612	1,126	1,756	(1,627 )	7,867
Income (loss) before income taxes	2,398	95	(632 )	-	1,861
Income tax expense (benefit)	599	43	(184 )	-	458
Net income (loss)	1,799	52	(448 )	-	1,403

Dividends on preferred shares	-	-	-	-	-
Net income (loss) applicable to common shares	\$ 1,799	\$ 52	\$ (448 )	\$ -	\$ 1,403
Intersegment revenue (expense)	\$ (1,598 )	\$ (29 )	\$ 1,627	\$ -	\$ -
Average assets	\$ 1,585,248	\$ 7,009	\$ 138,129	\$ (144,083 )	\$ 1,586,303

Summit Financial Group, Inc. and Subsidiaries  
 Management's Discussion and Analysis of Financial Condition and  
 Results of Operations

## INTRODUCTION

The following discussion and analysis focuses on significant changes in our financial condition and results of operations of Summit Financial Group, Inc. ("Company" or "Summit") and our operating segments, Summit Community Bank ("Summit Community"), and Summit Insurance Services, LLC for the periods indicated. See Note 14 of the accompanying consolidated financial statements for our segment information. This discussion and analysis should be read in conjunction with our 2009 audited financial statements and Annual Report on Form 10-K.

The Private Securities Litigation Act of 1995 indicates that the disclosure of forward-looking information is desirable for investors and encourages such disclosure by providing a safe harbor for forward-looking statements by us. Our following discussion and analysis of financial condition and results of operations contains certain forward-looking statements that involve risk and uncertainty. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed in those forward-looking statements.

## OVERVIEW

Our primary source of income is net interest income from loans and deposits. Business volumes tend to be influenced by the overall economic factors including market interest rates, business spending, and consumer confidence, as well as competitive conditions within the marketplace.

Interest earning assets declined by 7.16% for the first nine months in 2010 compared to the same period of 2009 while our net interest earnings on a tax equivalent basis decreased 10.42%. Our tax equivalent net interest margin decreased 11 basis points. Historically high levels of nonaccrual loans continue to negatively impact our net interest earnings and margin.

## BUSINESS SEGMENT RESULTS

We are organized and managed along two major business segments, as described in Note 14 of the accompanying consolidated financial statements. The results of each business segment are intended to reflect each segment as if it were a stand alone business. Net income by segment follows:

In thousands	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Community banking	\$ 277	\$ 1,799	\$ (2,111 )	\$ 847
Insurance	60	52	248	235
Parent and other	(539 )	(448 )	(1,245 )	(1,364 )
Consolidated net income	\$ (202 )	\$ 1,403	\$ (3,108 )	\$ (282 )

## CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the financial services industry. Application of these principles requires us to make estimates, assumptions, and judgments that affect the amounts reported in our financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

Summit Financial Group, Inc. and Subsidiaries  
 Management's Discussion and Analysis of Financial Condition and  
 Results of Operations

Our most significant accounting policies are presented in the notes to the consolidated financial statements of our 2009 Annual Report on Form 10-K. These policies, along with the other disclosures presented in the financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, we have identified the determination of the allowance for loan losses, the valuation of goodwill, fair value measurements and deferred tax assets to be the accounting areas that require the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.

**Allowance for Loan Losses:** The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 8 to the consolidated financial statements of our 2009 Annual Report on Form 10-K describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of the financial review of the 2009 Annual Report on Form 10-K.

**Goodwill:** Goodwill is subject to a two-step impairment test by reporting unit at least annually to determine whether write-downs of the recorded balances are necessary. During the third quarter, we completed the required annual impairment test for 2010 for each of our reporting units, community banking and insurance services. The first step (Step 1) of impairment testing requires a comparison of each reporting unit's fair value to its carrying value to identify potential impairment. If the fair value equals or exceeds the related unit's carrying value, no write-down of recorded goodwill is necessary. If the fair value is less than the carrying value, an expense may be required on our books to write down the goodwill to the proper carrying value. The second step (Step 2) of impairment testing is necessary only if the reporting unit does not pass Step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination.

The fair value, carrying amount and allocated goodwill with regard to each of our reporting units as of September 30, 2010 (date of our most recent goodwill impairment test) were as follows:

(in thousands)	Community Insurance	
	Banking	Services
Fair value	\$ 140,000	\$ 7,000
Carrying amount	126,755	6,651
Allocated goodwill	1,488	4,710



Neither of our reporting units failed Step 1 of the goodwill impairment tests conducted as of September 30, 2010. For purposes of these goodwill impairment tests, the following methodologies were utilized and key assumptions were made in determining the fair value of each reporting unit:

Community Banking – We performed an internal valuation utilizing the income approach to determine the fair value of our Community Banking reporting unit. The income approach was based on discounted cash flows derived from assumptions of balances sheet and income statement activity based upon an internally developed forecast considering several long-term key business drivers such as anticipated loan and deposit growth. The long term growth rate used in determining the terminal value was estimated at 3.5%, and a discount rate of 11% based upon the Capital Asset Pricing Model was applied to the Bank’s estimated future cash flow streams.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Insurance Services – We performed an internal valuation utilizing the income approach to determine the fair value of our Insurance Services reporting unit. This methodology consisted of discounting the expected future cash flows of this unit based upon a forecast of its operations considering long-term key business drivers such as anticipated commission revenue growth. The long term growth rate used in determining the terminal value was estimated at 0%, and a discount rate of 10% was applied to the Insurance Services unit's estimated future cash flows.

We cannot assure you that future goodwill impairment tests will not result in a charge to earnings. See Note 11 of the consolidated financial statements of our Annual Report on Form 10-K for further discussion of our intangible assets, which include goodwill.

Fair Value Measurements: ASC Topic 820 Fair Value Measurements and Disclosures provides a definition of fair value, establishes a framework for measuring fair value, and requires expanded disclosures about fair value measurements. Fair value is the price that could be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Based on the observability of the inputs used in the valuation techniques, we classify our financial assets and liabilities measured and disclosed at fair value in accordance with the three-level hierarchy (e.g., Level 1, Level 2 and Level 3) established under ASC Topic 820. Fair value determination in accordance with this guidance requires that we make a number of significant judgments. In determining the fair value of financial instruments, we use market prices of the same or similar instruments whenever such prices are available. We do not use prices involving distressed sellers in determining fair value. If observable market prices are unavailable or impracticable to obtain, then fair value is estimated using modeling techniques such as discounted cash flow analyses. These modeling techniques incorporate our assessments regarding assumptions that market participants would use in pricing the asset or the liability, including assumptions about the risks inherent in a particular valuation technique and the risk of nonperformance.

Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes in accordance with ASC Topic 825 Financial Instruments.

Deferred Income Tax Assets: At September 30, 2010, we had net deferred tax assets of \$10.6 million. Based on our ability to offset the net deferred tax asset against expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at September 30, 2010. All available evidence, both positive and negative, was considered to determine whether, based on the weight of that evidence, impairment should be recognized. However, our forecast process includes judgmental and quantitative elements that may be subject to significant change. If our forecast of taxable income within the carryback/carryforward periods available under applicable law is not sufficient to cover the amount of net deferred tax assets, such assets may become impaired.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

## RESULTS OF OPERATIONS

### Earnings Summary

Net income applicable to common shares for the nine months ended September 30, 2010 declined to a loss of \$3,108,000, or \$0.42 per diluted share as compared to a loss of \$282,000 or \$0.04 per diluted share for the same period of 2009. Net income applicable to common shares for the quarter ended September 30, 2010 declined to a loss of \$202,000, or \$0.03 per diluted share as compared to net income of \$1,403,000, or \$0.19 per diluted share for the quarter ended September 30, 2009. Earnings were negatively impacted for all periods by higher provisions for loan losses due to our increased nonperforming loans. The provision for loan losses was \$18.35 million and \$13.50 million for the nine months ended September 30, 2010 and 2009, respectively and \$4.5 million and \$4.0 million for the quarters ended September 30, 2010 and 2009, respectively. Included in earnings for the nine months ended September 30, 2010 was a \$2.2 million charge resulting from the write down of a portion of our OREO properties. Included in earnings for the nine months ended September 30, 2009 was an other-than-temporary non-cash impairment charge of \$5.0 million pre-tax, equivalent to \$3.1 million after-tax, or \$0.42 per diluted share. This impairment charge relates primarily to certain residential mortgage-backed securities, which we continue to own. Returns on average equity and assets for the first nine months of 2010 were (4.41%) and (0.25%), respectively, compared with (0.43%) and (0.02%) for the same period of 2009.

### Net Interest Income

Net interest income is the principal component of our earnings and represents the difference between interest and fee income generated from earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates as well as changes in the volume and mix of earning assets and interest bearing liabilities can materially impact net interest income.

Our net interest income on a fully tax-equivalent basis totaled \$30,742,000 for the nine months ended September 30, 2010 compared to \$34,319,000 for the same period of 2009, representing a decrease of \$3,577,000 or 10.42%. This decrease primarily resulted from a decline in interest earning assets, both loans and securities. Average interest earning assets decreased 7.16% from \$1,525,372,000 during the first nine months of 2009 to \$1,416,098,000 for the first nine months of 2010. Average interest bearing liabilities declined 5.48% from \$1,432,368,000 at September 30, 2009 to \$1,353,922,000 at September 30, 2010, at an average yield for the first nine months of 2010 of 3.03% compared to 3.25% for the same period of 2009.

Our consolidated net interest margin decreased to 2.90% for the nine months ended September 30, 2010, compared to 3.01% for the same period in 2009. The margin continues to be affected by elevated levels of nonaccruing loans. The present continued low interest rate environment has served to positively impact our net interest margin due to our liability sensitive balance sheet. For the nine months ended September 30, 2010 compared to September 30, 2009, the yields on earning assets decreased 26 basis points, while the cost of our interest bearing funds decreased by 22 basis points.

Late in third quarter 2010, and into fourth quarter 2010, we reduced or repriced over \$100 million of our higher-rate long-term borrowings which we expect to have a favorable impact on our net interest margin by reducing our cost of funds as follows:

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- \$56 million of long term FHLB advances matured or were paid off at an average rate of 5.44%
- \$27 million of long term repurchase agreements repriced from an average rate of 9.18% to 4.63%.
- \$20.9 million of brokered certificates of deposit matured at an average rate of 4.6% and was replaced with \$23.7 million at an average rate of 2.8%

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Assuming no significant change in market interest rates, we anticipate an improved net interest margin in the near term as a result of our anticipated lower cost of funds, we do not expect interest rates to rise in the near future, we do not expect significant growth in our interest earning assets, nor do we expect our nonperforming asset balances to decline significantly in the near future. We continue to monitor the net interest margin through net interest income simulation to minimize the potential for any significant negative impact. See the "Market Risk Management" section for further discussion of the impact changes in market interest rates could have on us. Further analysis of our yields on interest earning assets and interest bearing liabilities are presented in Tables I and II below.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Table I - Average Balance Sheet and Net Interest Income Analysis  
Dollars in thousands

	For the Nine Months Ended					
	September 30, 2010			September 30, 2009		
	Average Balance	Earnings/ Expense	Yield/ Rate	Average Balance	Earnings/ Expense	Yield/ Rate
<b>Interest earning assets</b>						
Loans, net of unearned income (1)						
Taxable	\$1,104,611	\$49,519	5.99%	\$1,191,692	\$54,033	6.06%
Tax-exempt (2)	6,177	367	7.94%	8,112	502	8.27%
<b>Securities</b>						
Taxable	250,511	9,494	5.07%	277,558	12,226	5.89%
Tax-exempt (2)	40,778	2,032	6.66%	46,988	2,382	6.78%
Federal funds sold and interest bearing deposits with other banks						
	14,021	21	0.20%	1,022	6	0.78%
Total interest earning assets	1,416,098	61,433	5.80%	1,525,372	69,149	6.06%
<b>Noninterest earning assets</b>						
Cash & due from banks	4,280			14,110		
Premises and equipment	23,896			23,446		
Other assets	100,597			55,390		
Allowance for loan losses	(19,243)			(19,377)		
Total assets	\$1,525,628			\$1,598,941		
<b>Interest bearing liabilities</b>						
Interest bearing demand deposits						
	\$146,152	\$463	0.42%	\$154,945	\$586	0.51%
Savings deposits	193,769	1,883	1.30%	96,011	1,173	1.63%
Time deposits	600,976	13,691	3.05%	636,569	17,314	3.64%
Short-term borrowings						
	20,998	79	0.50%	113,896	487	0.57%
Long-term borrowings and capital trust securities						
	392,027	14,575	4.97%	430,947	15,270	4.74%
Total interest bearing liabilities	1,353,922	30,691	3.03%	1,432,368	34,830	3.25%

Noninterest bearing  
liabilities

and shareholders'  
equity

Demand deposits	72,329	71,359
Other liabilities	8,609	8,592
Shareholders' equity	90,768	86,622
Total liabilities and shareholders' equity	\$1,525,628	\$1,598,941
Net interest earnings	\$30,742	\$34,319
Net yield on interest earning assets	2.90%	3.01%

(1) For purposes of this table, nonaccrual loans are included in average loan balances.

(2) - Interest income on tax-exempt securities has been adjusted assuming an effective tax rate of 34% for all periods presented.

The tax equivalent adjustment resulted in an increase in interest income of \$1,037,000 and \$981,000 for the periods ended

September 30, 2010 and September 30  
2009, respectively.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Table II - Changes in Interest Margin Attributable to Rate and Volume

In thousands	For the Three Months Ended		
	September 30, 2010 versus September 30, 2009		
	Increase (Decrease) Due to Change in:		
	Volume	Rate	Net
Interest earned on:			
Loans			
Taxable	\$ (3,909 )	\$ (605 )	\$ (4,514 )
Tax-exempt	(116 )	(19 )	(135 )
Securities			
Taxable	(1,123 )	(1,609 )	(2,732 )
Tax-exempt	(310 )	(40 )	(350 )
Federal funds sold and interest bearing deposits with other banks			
	22	(7 )	15
Total interest earned on interest earning assets			
	(5,436 )	(2,280 )	(7,716 )
Interest paid on:			
Interest bearing demand deposits			
	(32 )	(91 )	(123 )
Savings deposits	991	(281 )	710
Time deposits	(928 )	(2,695 )	(3,623 )
Short-term borrowings	(355 )	(53 )	(408 )
Long-term borrowings and capital trust securities			
	(1,423 )	728	(695 )
Total interest paid on interest bearing liabilities			
	(1,747 )	(2,392 )	(4,139 )
Net interest income			
	\$ (3,689 )	\$ 112	\$ (3,577 )

## Noninterest Income

Total noninterest income increased to \$6,484,000 for the first nine months of 2010, compared to \$2,931,000 for the same period of 2009, with smaller other-than-temporary impairment charges on securities being the primary positive component. Further detail regarding noninterest income is reflected in the following table.

Noninterest Income	For the Quarter Ended		For the Nine Months	
	September 30,		Ended September 30,	
In thousands	2010	2009	2010	2009



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Insurance commissions	\$ 1,227	\$ 1,254	\$ 3,659	\$ 3,881
Service fees	763	859	2,298	2,452
Realized securities gains (losses)	67	428	1,587	723
Other-than-temporary impairment of securities	(109 )	-	(138 )	(4,983 )
Gain (loss) on sale of assets	(84 )	9	111	(115 )
Writedown of OREO	-	-	(2,194 )	-
Other	422	282	1,161	973
Total	\$ 2,286	\$ 2,832	\$ 6,484	\$ 2,931

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Other-than-temporary impairment of securities: During the first nine months of 2009, we recorded a non-cash other-than temporary impairment charge of \$4,768,000 related to certain residential mortgage-backed securities which we continue to own. The remaining \$215,000 other-than-temporary impairment charge on securities during 2009 was related to an equity investment.

Writedown of OREO: During the first nine months of 2010, we recorded a \$2,194,000 charge to writedown certain OREO properties to estimated fair value as part of our normal, ongoing re-appraisal process. \$2,130,000 of this writedown is attributable to three residential subdivisions located within Berkeley County, West Virginia.

### Noninterest Expense

Total noninterest expense decreased approximately 4.1% for the nine months ended September 30, 2010, as compared to the same period in 2009. These expenses increased slightly for third quarter 2010 compared to third quarter 2009. While OREO expenses continue to increase due to higher levels of foreclosed properties, salaries, commissions, and employee benefits decreased for the nine months ended September 30, 2010 compared to the same period of 2009 due to compensation freezes and staff reductions and FDIC premiums are lower in 2010 due to the special assessment that occurred during second quarter 2009. Table III below shows the breakdown of the changes.

Table III -  
Noninterest Expense

Dollars in thousands	For the Quarter Ended September 30,				For the Nine Months Ended September 30,			
	2010	\$	Change	2009	2010	\$	Change	2009
Salaries, commissions, and employee benefits	\$ 3,866	\$ 4	0.1 %	\$ 3,862	\$ 11,428	\$ (1,021)	-8.2 %	\$ 12,449
Net occupancy expense	498	14	2.9 %	484	1,529	(19 )	-1.2 %	1,548
Equipment expense	620	(34 )	-5.2 %	654	1,883	(107 )	-5.4 %	1,990
Supplies	117	3	2.6 %	114	360	45	14.3 %	315
Professional fees	223	(107 )	-32.4 %	330	759	(308 )	-28.9 %	1,067
Amortization of intangibles	88	-	0.0 %	88	263	-	0.0 %	263
FDIC premiums	715	55	8.3 %	660	2,165	(123 )	-5.4 %	2,288
OREO expense	671	532	382.7 %	139	1,147	852	288.8 %	295
Other	1,262	(274 )	-17.8 %	1,536	3,791	(321 )	-7.8 %	4,112
Total	\$ 8,060	\$ 193	2.5 %	\$ 7,867	\$ 23,325	\$ (1,002)	-4.1 %	\$ 24,327

### Credit Experience

Due to current recessionary economic conditions, borrowers have in many cases been unable to meet their current debt obligation due to a range of factors including declining property values and elevated unemployment levels. As a result, we have experienced higher delinquencies and nonperforming assets, particularly in our residential real estate loan portfolios and in commercial construction loans to residential real estate developers. It is not known when the

housing market will stabilize. Management anticipates loan delinquencies will remain higher than historical levels for the near term, and we anticipate that nonperforming assets will remain elevated for the foreseeable future.

The provision for loan losses represents charges to earnings necessary to maintain an adequate allowance for probable credit losses inherent in the loan portfolio. Our determination of the appropriate level of the allowance is based on an ongoing analysis of credit quality and loss potential in the loan portfolio, change in the composition and risk characteristics of the loan portfolio, and the anticipated influence of national and local economic conditions. The adequacy of the allowance for loan losses is reviewed quarterly and adjustments are made as considered necessary.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

We recorded \$4,500,000 and \$18,350,000 provisions for loan losses for the third quarter and first nine months of 2010, respectively, compared to \$4,000,000 and \$13,500,000 for the same periods in 2009. During third quarter 2010, we charged off several loans which had specific reserve allocations. Therefore, our specific reserves decreased while our general reserve increased as a result of continuing historically high quarterly net loan charge off's which resulted in a \$1.5 million increase to the quantitative reserve component of our allowance for loan losses during third quarter 2010. At September 30, 2010, the allowance for loan losses totaled \$18,869,000 or 1.82% of loans, net of unearned income, compared to \$17,000,000 or 1.47% of loans, net of unearned income, at December 31, 2009.

As illustrated in Table IV below, our non-performing assets have increased during the past 12 months.

Table IV - Summary of  
Non-Performing Assets

In thousands	2010	September 30, 2009	December 31, 2009
Accruing loans past due 90 days or more	\$ 2,415	\$ 781	\$ 201
Nonaccrual loans			
Commercial	880	396	408
Commercial real estate	5,386	22,294	35,217
Commercial construction and development	-	10,354	11,553
Residential construction and development	14,419	16,730	14,775
Residential real estate	6,153	8,263	4,407
Consumer	60	34	381
Total nonaccrual loans	26,898	- 58,071	- 66,741
Foreclosed properties			
Commercial	-	-	-
Commercial real estate	13,091	4,873	4,788
Commercial construction and development	16,691	1,903	2,028
Residential construction and	35,197	23,375	30,230

development					
Residential real estate	3,374		1,042		3,247
Consumer	-		-		-
Total foreclosed properties	68,353	-	31,193	-	40,293
Repossessed assets	314		1		269
Total nonperforming assets	\$ 97,980		\$ 90,046		\$ 107,504
Total nonperforming loans as a percentage of total loans	2.82 %		5.02 %		5.79 %
Total nonperforming assets as a					

The following table presents a summary of our 30 to 89 days past due performing loans.

Loans Past Due 30-89 Days					
		For the Quarter Ended			
In thousands	9/30/2010	6/30/2010	3/31/2010	12/31/2009	9/30/2009
Commercial	\$ 817	\$ 516	\$ 1,209	\$ 1,585	\$ 177
Commercial real estate	1,933	9,246	9,497	3,861	5,064
Construction and development	1,711	819	11,654	1,161	9,362
Residential real estate	7,050	10,846	8,638	8,250	8,381
Consumer	691	536	419	835	810
Total	\$ 12,202	\$ 21,963	\$ 31,417	\$ 15,692	\$ 23,794

Summit Financial Group, Inc. and Subsidiaries  
 Management's Discussion and Analysis of Financial Condition and  
 Results of Operations

The following table details our most significant nonperforming loan relationships at September 30, 2010.

Significant  
 Nonperforming  
 Loan  
 Relationships  
 September 30,  
 2010  
 In thousands

Location by Region	Underlying Collateral	Loan Origination Date	Loan Nonaccrual Date	Current Loan Balance	Method Used to Measure Impairment	Most Recent Appraised Value	Amount Allocated to Allowance for Loan Losses	Previously Charged-off
North Central WV No. Shenandoah Valley, VA Rockingham Co., VA & Hardy Co., WV No. Shenandoah Valley, VA	Residential building lots & undeveloped residential & commercial acreage	Aug. 2008	Jun. 2010	\$ 5,306	Collateral value	\$ 2,000(1)	\$ 3,466	\$ -
	Single family residence	Oct. 2006	Oct. 2010	\$ 1,291	Collateral value	\$ 815 (1)	\$ 557	\$ -
	Residential subdivision & undeveloped acreage	Nov. 2007	Mar. 2009	\$ 3,715	Collateral value	\$ 3,034(1)	\$ 1,097	\$ -
	Commercial building	Nov. 2006	Jun. 2010	\$ 2,024	Collateral value	\$ 2,076(1)	\$ 148	\$ -
Northern VA Hardy Co., WV	Commercial building & equipment	Jan. 2009 & Oct. 2008	Jun. 2010 & Jul. 2009 Sept. 2010	\$ 1,306 \$ 1,188	Collateral value	\$ 1,490(2) \$ 1,233(3)	\$ - \$ 363	\$ -
Western MD and Florida	Residential development, undeveloped acreage, 2 residential condos, a single family residence and a residential building lot	Various 2003-2007	Jun. 2010	\$ 5,819	Collateral value	\$ 7,937(1)	\$ 531	\$ -

(1) - Values are based upon recent external appraisal.

(2) - Values for equipment are based upon equipment trader prices and management's estimate of value.

(3)- Value is based upon appraisal obtained at loan origination. New appraisal has been ordered.

As a result of our internal loan review process, the ratio of internally criticized loans to total loans decreased from 10.66% at December 31, 2009 to 9.43% at September 30, 2010. Our internal loan review process includes a watch list of loans that have been specifically identified through the use of various sources, including past due loan reports, previous internal and external loan evaluations, classified loans identified as part of regulatory agency loan reviews and reviews of new loans representative of current lending practices. Once this watch list is reviewed to ensure it is complete, we review the specific loans for collectability, performance and collateral protection. In addition, a grade is assigned to the individual loans utilizing internal grading criteria, which is somewhat similar to the criteria utilized by our subsidiary bank's primary regulatory agency. The decreases in the commercial real estate and land development and construction categories were primarily the result of foreclosures. Refer to the Asset Quality section of the financial review of the 2009 Annual Report on Form 10-K for further discussion of the processes related to internally classified loans.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Internally Criticized  
Loans

In thousands	9/30/2010	6/30/2010	3/31/2010	12/31/2009
Commerical	\$ 7,272	\$ 8,113	\$ 7,342	\$ 6,413
Commercial real estate	35,401	45,971	63,079	56,726
Land development & construction	27,544	27,216	30,145	38,279
Residential real estate	27,788	24,714	22,705	21,854
Consumer	-	-	-	-
Total	\$ 98,005	\$ 106,014	\$ 123,271	\$ 123,272

Included in the above table of internally criticized loans are approximately \$4.9 million of performing loans which we have identified as potential problem loans at September 30, 2010. These loans are performing at September 30, 2010, but known information about possible credit problems of the related borrowers causes management to have concerns as to the ability of such borrowers to comply with the current loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, or require increased allowance coverage and provision for loan losses.

We maintain the allowance for loan losses at a level considered adequate to provide for estimated probable credit losses inherent in the loan portfolio. The allowance is comprised of three distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated, and (3) qualitative reserves related to loans collectively evaluated. A summary of the methodology we employ on a quarterly basis with respect to each of these components in order to evaluate the overall adequacy of our allowance for loan losses is as follows:

#### Specific Reserve for Loans Individually Evaluated

First, we identify loan relationships having aggregate balances in excess of \$500,000 and that may also have credit weaknesses. Such loan relationships are identified primarily through our analysis of internal loan evaluations, past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – that is, based on current information and events it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of our impaired loans are and historically have been collateral dependent, meaning repayment of the loan is expected to be provided solely from the sale of the loan's underlying collateral. While our collateral-dependant impaired loans typically are guaranteed by the principles and/or related interests of the borrower, rarely is it deemed probable that such guarantees will result in any meaningful repayment of the loan. For such loans, we measure impairment based on the fair value of the loan's collateral, which is generally determined utilizing current appraisals. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell. Our policy is to re-evaluate the fair value of collateral dependent loans at least every twelve months unless there is a known



deterioration in the collateral's value, in which case a new appraisal is obtained.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Quantitative Reserve for Loans Collectively Evaluated

Second, we stratify the loan portfolio into the following ten loan pools: land and land development, construction, commercial, commercial real estate -- owner-occupied, commercial real estate -- non-owner occupied, conventional residential mortgage, jumbo residential mortgage, home equity, consumer, and other. Loans within each pool are then further segmented between (1) loans which were individually evaluated for impairment and not deemed to be impaired, (2) larger-balance loan relationships exceeding \$2 million which are assigned an internal risk rating in conjunction with our normal ongoing loan review procedures and (3) smaller-balance homogenous loans.

Quantitative reserves relative to each loan pool are established as follows: for loan segments (1) and (2) above, the recorded investment of these loans within each pool are aggregated according to their internal risk ratings, and an allocation ranging from 5% to 200% of the respective pool's average historical net loan charge-off rate (determined based upon the most recent twelve quarters) is applied to the aggregate recorded investment in loans by internal risk category, such lower-rated loan relationships receive higher allocations of reserves; for loan segment (3) above, an allocation equaling 100% of the respective pool's average historical net loan charge-off rate (determined based upon the most recent twelve quarters) is applied to the aggregate recorded investment in the smaller-balance homogenous pool of loans.

Qualitative Reserve for Loans Collectively Evaluated

Third, we consider the necessity to adjust our average historical net loan charge-off rates relative to each of the above ten loan pools for potential risks factors that could result in actual losses deviating from prior loss experience. For example, if we observe a significant increase in delinquencies within the conventional mortgage loan pool above historical trends, an additional allocation to the average historical loan charge-off rate is applied. Such qualitative risk factors considered are: (1) levels of and trends in delinquencies and impaired loans, (2) levels of and trends in charge-offs and recoveries, (3) trends in volume and term of loans, (4) effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practice, (5) experience, ability, and depth of lending management and other relevant staff, (6) national and local economic trends and conditions, (7) industry conditions, and (8) effects of changes in credit concentrations.

Relationship between Allowance for Loan Losses, Net Charge-offs and Nonperforming Loans

In analyzing the relationship between the allowance for loan losses, net loan charge-offs and nonperforming loans, it is helpful to understand the process of how loans are treated as they deteriorate over time. Reserves for loans are established at origination through the quantitative and qualitative reserve process discussed above. If the quality of a loan which is reviewed as part of our normal internal loan review procedures deteriorates, it migrates to a lower quality risk rating, and accordingly, a higher reserve amount is assigned.

Charge-offs, if necessary, are typically recognized in a period after the reserves were established. If the previously established reserves exceed that needed to satisfactorily resolve the problem credit, a reduction in the overall level of the reserve could be recognized. In summary, if loan quality deteriorates, the typical credit sequence is periods of reserve building, followed by periods of higher net charge-offs.

Consumer loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit

card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), whichever is earlier. Residential mortgage loans are generally charged off to net realizable value no later than when the account becomes 180 days past due. Other consumer loans, if collateralized, are generally charged off to net realizable value at 120 days past due.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Substantially all of our nonperforming loans are secured by real estate. The substantial majority of these loans were underwritten in accordance with our loan-to-value policy guidelines which range from 70-85% at the time of origination. Although property values have deteriorated across our market areas, the fair values of the underlying collateral value remains in excess of the recorded investment relative to approximately 39% (by dollar volume) of our nonperforming loans that were evaluated for impairment at September 30, 2010, and therefore in such cases no specific reserve allocation is required. Due to the fact that our allowance for loan losses on impaired loans is based on the fair value of the underlying collateral less cost to sell, our allowance for loan losses will not always increase proportionately as our nonperforming loans increase. The allowance for loan loss will, however, increase as a result of an increase in net loan charge-offs due to the incremental higher historical net charge-off rates applied to the loans which are collectively evaluated for impairment.

At September 30, 2010, December 31, 2009, and September 30, 2009, our allowance for loan losses totaled \$18,869,000, or 1.82% of total loans, \$17,000,000, or 1.47% of total loans and \$13,848,000, or 1.18% of total loans, respectively, and is considered adequate to cover inherent losses in our loan portfolio.

At September 30, 2010, December 31, 2009, and September 30, 2009, we had approximately \$68,353,000, \$40,293,000 and \$31,193,000, respectively, in other real estate owned which was obtained as the result of foreclosure proceedings. Although foreclosed property is recorded at fair value less estimated costs to sell, the prices ultimately realized upon their sale may or may not result in us recognizing loss.

## FINANCIAL CONDITION

Our total assets were \$1,496,412,000 at September 30, 2010, compared to \$1,584,625,000 at December 31, 2009, representing a 5.6% decrease. Table V below serves to illustrate significant changes in our financial position between December 31, 2009 and September 30, 2010.

Table V - Summary of Significant Changes in Financial Position

Dollars in thousands	Balance December 31, 2009	Increase (Decrease) Amount	Percentage	Balance September 30, 2010
<b>Assets</b>				
Securities available for sale	\$ 271,654	(3,798 )	-1.4 %	\$ 267,856
Loans, net of unearned interest	1,154,336	(117,298)	-10.2 %	1,037,038
<b>Liabilities</b>				
Deposits	\$ 1,017,338	\$ 12,694	1.2 %	\$ 1,030,032
Short-term borrowings	49,739	(48,129 )	-96.8 %	1,610
Long-term borrowings	381,492	(51,844 )	-13.6 %	329,648
	16,800	-	0.0 %	16,800

Subordinated debentures					
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	-	0.0 %	19,589	

Loans decreased 10.2% and securities decreased 1.4% during the first nine months of 2010. We have restricted our growth in order to improve our capital ratios.

Deposits increased approximately \$12.7 million during the first nine months of 2010, primarily in retail deposits.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

The decrease in both short term and long term borrowings is primarily attributable to paying down FHLB overnight advances and the maturities and repayments of long-term FHLB advances during the first nine months of 2010 funded by reductions in loans and securities portfolios.

Refer to Notes 6, 7, 9, and 10 of the notes to the accompanying consolidated financial statements for additional information with regard to changes in the composition of our securities, loans, deposits and borrowings between September 30, 2010 and December 31, 2009.

### LIQUIDITY AND CAPITAL RESOURCES

Liquidity reflects our ability to ensure the availability of adequate funds to meet loan commitments and deposit withdrawals, as well as provide for other transactional requirements. Liquidity is provided primarily by funds invested in cash and due from banks (net of float and reserves), Federal funds sold, non-pledged securities, and available lines of credit with the Federal Home Loan Bank of Pittsburgh ("FHLB"), which totaled approximately \$272.9 million or 18.2% of total consolidated assets at September 30, 2010.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit activity. As a member of the FHLB, we have access to approximately \$416 million. As of September 30, 2010 and December 31, 2009, these advances totaled approximately \$207 million and \$304 million, respectively. At September 30, 2010, we had additional borrowing capacity of \$208 million through FHLB programs. We have established a line with the Federal Reserve Bank to be used as a contingency liquidity vehicle. The amount available on this line at September 30, 2010 was approximately \$83 million, which is secured by a pledge of our consumer and commercial and industrial loan portfolios. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises.

Liquidity risk represents the risk of loss due to the possibility that funds may not be available to satisfy current or future commitments based on external market issues, customer or creditor perception of financial strength, and events unrelated to Summit such as war, terrorism, or financial institution market specific issues. The Asset/Liability Management Committee ("ALCO"), comprised of members of senior management and certain members of the Board of Directors, oversees our liquidity risk management process. The ALCO develops and recommends policies and limits governing our liquidity to the Board of Directors for approval with the objective of ensuring that we can obtain cost-effective funding to meet current and future obligations, as well as maintain sufficient levels of on-hand liquidity, under both normal and "stressed" circumstances.

One aspect of our liquidity management process is establishing contingency liquidity funding plans under various scenarios in order to prepare for unexpected liquidity shortages or events. The following represents three "stressed" liquidity circumstances and our related contingency plans with respect to each.

Scenario 1 – Summit Community's capital status becomes less than "well capitalized". Banks which are less than "well capitalized" in accordance with regulatory capital guidelines are prohibited from issuing new brokered deposits without first obtaining a waiver from the FDIC to do so. In the event Summit Community's capital status were to fall below well capitalized and was not successful in obtaining the FDIC's waiver to issue new brokered deposits, Summit Community:

-

Would have limited amounts of maturing brokered deposits to replace in the short-term, as we have limited our brokered deposits maturing in any one quarter to no more than \$50 million.

- Presently has \$356 million in available sources of liquid funds which could be drawn upon to fund maturing brokered deposits until Summit Community had restored its capital to well capitalized status.
- Would first seek to restore its capital to well capitalized status through capital contributions from Summit, its parent holding company. Summit has present cash reserves in excess of \$5 million available for capital infusion into Summit Community.
- Would generally have no more than \$100 million in brokered deposits maturing in any one year time frame, which is well within its presently available sources of liquid funds, if in the event Summit does not have the capital resources to restore Summit Community's capital to well capitalized status. One year would give Summit Community ample time to raise alternative funds either through retail deposits or the sale of assets, and obtain capital resources to restore it to well capitalized status.

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

Scenario 2 – Summit Community's credit quality deteriorates such that the FHLB restricts further advances. If in the event that the Bank's credit quality deteriorated to the point that further advances under its line with the FHLB were restricted, Summit Community:

- Would severely curtail lending and other growth activities until such time as access to this line could be restored, thus eliminating the need for net new advances.
- Would still have available current liquid funding sources totaling \$106 million aside from its FHLB line and,
- In addition, would have available currently almost \$49 million unpledged government agency securities (debentures and mortgage backed securities) that are available for use in repurchase arrangements with institutional broker and would result in a funding source of at least \$39 million to meet unforeseen liquidity needs.

Scenario 3 – A competitive financial institution offers a retail deposit program at interest rates significantly above current market rates in the Summit Community's market areas. If a competitive financial institution offered a retail deposit program at rates well in excess of current market rates in the Summit Community's market area, the Bank:

- Presently has \$356 million in available sources of liquid funds which could be drawn upon immediately to fund any "net run off" of deposits from this activity.
- Would severely curtail lending and other growth activities so as to preserve the availability of as much contingency funds as possible.
- Would begin offering its own competitive deposit program when deemed prudent so as to restore the retail deposits lost to the competition.

We continuously monitor our liquidity position to ensure that day-to-day as well as anticipated funding needs are met. We are not aware of any trends, commitments, events or uncertainties that have resulted in or are reasonably likely to result in a material change to our liquidity.

One of our continuous goals is maintenance of a strong capital position. Through management of our capital resources, we seek to provide an attractive financial return to our shareholders while retaining sufficient capital to support future growth. Shareholders' equity at September 30, 2010 totaled \$90,234,000 compared to \$90,660,000 at December 31, 2009.

Summit and Summit Community have each entered into informal Memoranda of Understanding ("MOU's") with their respective regulatory authorities. A memorandum of understanding is characterized by the regulatory authorities as an informal action that is not published or publicly available and that is used when circumstances warrant a milder form of action than a formal supervisory action, such as a formal written agreement or order. Among other things, under the MOU's, Summit's management team has agreed to:

- Summit Community achieving and maintaining a minimum Tier 1 leverage capital ratio of at least 8% and a total risk-based capital ratio of at least 11%;



Summit Financial Group, Inc. and Subsidiaries  
 Management's Discussion and Analysis of Financial Condition and  
 Results of Operations

- Summit Community providing 30 days prior notice of any declaration of intent to pay cash dividends to provide the Bank's regulatory authorities an opportunity to object;
- Summit suspending all cash dividends on its common stock until further notice. Dividends on all preferred stock, as well as interest payments on subordinated notes underlying Summit's trust preferred securities, continue to be permissible; and,
- Summit not incurring any additional debt, other than trade payables, without the prior written consent of the banking regulators.

Management presently believes Summit and the Bank are in compliance with all provisions of the MOUs.

Refer to Note 13 of the notes to the accompanying consolidated financial statements for additional information regarding regulatory restrictions on our capital as well as our subsidiaries' capital.

CONTRACTUAL CASH OBLIGATIONS

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at September 30, 2010.

Dollars in thousands	Long Term Debt	Capital Trust Securities	Operating Leases
2010	\$ 25,539	\$ -	\$ 63
2011	35,395	-	199
2012	66,720	-	151
2013	41,885	-	138
2014	83,416	-	125
Thereafter	113,082	19,589	21
Total	\$ 366,037	\$ 19,589	\$ 697

OFF-BALANCE SHEET ARRANGEMENTS

We are involved with some off-balance sheet arrangements that have or are reasonably likely to have an effect on our financial condition, liquidity, or capital. These arrangements at September 30, 2010 are presented in the following table.

September  
30,

Dollars in thousands 2010  
 Commitments to  
 extend credit:

Revolving home equity and credit card lines	\$ 43,813
Construction loans	19,489
Other loans	36,984
Standby letters of credit	2,735
Total	\$ 103,021

Summit Financial Group, Inc. and Subsidiaries  
 Management's Discussion and Analysis of Financial Condition and  
 Results of Operations

MARKET RISK MANAGEMENT

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. Interest rate risk is our primary market risk and results from timing differences in the repricing of assets, liabilities and off-balance sheet instruments, changes in relationships between rate indices and the potential exercise of imbedded options. The principal objective of asset/liability management is to minimize interest rate risk and our actions in this regard are taken under the guidance of our Asset/Liability Management Committee ("ALCO"), which is comprised of members of senior management and members of the Board of Directors. The ALCO actively formulates the economic assumptions that we use in our financial planning and budgeting process and establishes policies which control and monitor our sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position is liability sensitive. The nature of our lending and funding activities tends to drive our interest rate risk position to being liability sensitive. That is, absent any changes in the volumes of our interest earning assets or interest bearing liabilities, liabilities are likely to reprice faster than assets, resulting in a decrease in net income in a rising rate environment. Net income would increase in a falling interest rate environment. Net income is also subject to changes in the shape of the yield curve. In general, a flattening yield curve would result in a decline in our earnings due to the compression of earning asset yields and funding rates, while a steepening would result in increased earnings as margins widen.

Several techniques are available to monitor and control the level of interest rate risk. We primarily use earnings simulations modeling to monitor interest rate risk. The earnings simulation model forecasts the effects on net interest income under a variety of interest rate scenarios that incorporate changes in the absolute level of interest rates and changes in the shape of the yield curve. Each increase or decrease in interest rates is assumed to gradually take place over the next 12 months, and then remain stable, except for the up 400 scenario, which assumes a gradual increase in rates over 24 months. Assumptions used to project yields and rates for new loans and deposits are derived from historical analysis. Securities portfolio maturities and prepayments are reinvested in like instruments. Mortgage loan prepayment assumptions are developed from industry estimates of prepayment speeds. Noncontractual deposit repricings are modeled on historical patterns.

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of September 30, 2010. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable thereafter for the up and down 100 and the up 200 scenarios, and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above and are well within our ALCO policy limit, which is a 10% reduction in net interest income over the ensuing twelve month period.

	Estimated %
Change in Interest Rates	Change in Net Interest Income Over:

(basis points)	0-12 Months	13-24 Months
Down 100 (1)	1.59%	6.34%
Up 100 (1)	-0.78%	3.33%
Up 200 (1)	-2.28%	1.17%
Up 400 (2)	-2.26%	0.34%

(1) assumes a parallel shift in the yield curve  
 (2) assumes 400 bp increase over 24 months

Summit Financial Group, Inc. and Subsidiaries  
Management's Discussion and Analysis of Financial Condition and  
Results of Operations

CONTROLS AND PROCEDURES

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of September 30, 2010, an evaluation of the effectiveness of disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of September 30, 2010 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Summit Financial Group, Inc. and Subsidiaries  
Part II. Other Information

Item 1. Legal Proceedings

We are involved in various legal actions arising in the ordinary course of business. In the opinion of management, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SUMMIT FINANCIAL GROUP, INC.  
(registrant)

By: /s/ H. Charles Maddy, III  
H. Charles Maddy, III,  
President and Chief Executive Officer

By: /s/ Robert S. Tissue  
Robert S. Tissue,  
Senior Vice President and Chief Financial Officer

By: /s/ Julie R. Cook  
Julie R. Cook,  
Vice President and Chief Accounting Officer

Date: November 15, 2010

