

SUMMIT FINANCIAL GROUP INC
Form 10-Q
May 03, 2012

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 March 31, 2012.

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

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

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 April 30, 2012

Summit Financial Group, Inc. and Subsidiaries
Table of Contents

	Page	
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated balance sheets March 31, 2012 (unaudited), December 31, 2011, and March 31, 2011 (unaudited)	4
	Consolidated statements of income for the three months ended March 31, 2012 and 2011 (unaudited)	5
	Consolidated statements of comprehensive income for the three months ended March 31, 2012 and 2011 (unaudited)	6
	Consolidated statements of shareholders' equity for the three months ended March 31, 2012 and 2011 (unaudited)	7
	Consolidated statements of cash flows for the three months ended March 31, 2012 and 2011 (unaudited)	8-9
	Notes to consolidated financial statements (unaudited)	10-40
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	41-57
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	56
Item 4.	Controls and Procedures	57

Summit Financial Group, Inc. and Subsidiaries
Table of Contents

	Page
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	58
Item 1A. Risk Factors	58
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	None
Item 3. Defaults upon Senior Securities	None
Item 4. Mine Safety Disclosures	None
Item 5. Other Information	None
Item 6. Exhibits	58
SIGNATURES	59
EXHIBIT INDEX	60

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

Dollars in thousands	March 31, 2012 (unaudited)	December 31, 2011 (*)	March 31, 2011 (unaudited)
ASSETS			
Cash and due from banks	\$ 4,059	\$ 4,398	\$ 4,263
Interest bearing deposits with other banks	26,855	28,294	46,448
Securities available for sale	292,002	286,599	293,240
Other investments	18,342	19,146	21,956
Loans held for sale, net	1,126	-	402
Loans, net	957,797	965,516	979,387
Property held for sale	61,584	63,938	66,961
Premises and equipment, net	21,756	22,084	22,784
Accrued interest receivable	5,269	5,784	5,797
Intangible assets	8,563	8,651	8,914
Cash surrender value of life insurance policies	29,559	29,284	13,252
Other assets	17,453	16,427	18,791
Total assets	\$ 1,444,365	\$ 1,450,121	\$ 1,482,195
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	\$ 87,916	\$ 88,655	\$ 86,735
Interest bearing	923,223	927,845	975,384
Total deposits	1,011,139	1,016,500	1,062,119
Short-term borrowings	15,956	15,956	1,879
Long-term borrowings	267,121	270,254	283,516
Subordinated debentures	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	9,361	8,456	8,964
Total liabilities	1,339,966	1,347,555	1,392,867
Commitments and Contingencies			
Shareholders' Equity			
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	3,519
Series 2011, 8% Non-cumulative convertible preferred stock,			

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

par value \$1.00; issued March 2012 and December 2011 - 12,000 shares	5,807	5,807	-
Common stock and related surplus - authorized 20,000,000 shares; \$2.50 par value; issued and outstanding 2012 and 2011 - 7,425,472 shares	24,519	24,518	24,515
Retained earnings	66,408	64,904	60,879
Accumulated other comprehensive income	4,146	3,818	415
Total shareholders' equity	104,399	102,566	89,328
Total liabilities and shareholders' equity	\$ 1,444,365	\$ 1,450,121	\$ 1,482,195

(*) - December 31, 2011 financial information has been extracted from audited consolidated financial statements
 See Notes to Consolidated Financial Statements

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

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

Dollars in thousands, except per share amounts	Three Months Ended	
	March 31, 2012	March 31, 2011
Interest income		
Interest and fees on loans		
Taxable	\$ 14,280	\$ 15,075
Tax-exempt	86	65
Interest and dividends on securities		
Taxable	1,699	2,609
Tax-exempt	721	434
Interest on interest bearing deposits with other banks	11	17
Total interest income	16,797	18,200
Interest expense		
Interest on deposits	3,714	4,743
Interest on short-term borrowings	6	1
Interest on long-term borrowings and subordinated debentures	3,059	3,354
Total interest expense	6,779	8,098
Net interest income	10,018	10,102
Provision for loan losses	2,001	3,000
Net interest income after provision for loan losses	8,017	7,102
Other income		
Insurance commissions	1,158	1,242
Service fees related to deposit accounts	1,014	888
Realized securities gains	1,165	1,628
Gain (loss) on sale of assets	(77)	71
Writedown of foreclosed properties	(1,912)	(3,443)
Bank owned life insurance income	275	131
Other	309	230
Total other-than-temporary impairment loss on securities	(511)	(1,828)
Portion of loss recognized in other comprehensive income	282	600
Net impairment loss recognized in earnings	(229)	(1,228)
Total other income	1,703	(481)
Other expense		
Salaries, commissions, and employee benefits	3,901	3,972
Net occupancy expense	479	509
Equipment expense	594	580
Professional fees	304	197
Amortization of intangibles	88	88
FDIC premiums	522	693
Foreclosed properties expense	374	434
Other	1,277	634
Total other expense	7,539	7,107
Income (loss) before income taxes	2,181	(486)
Income tax expense (benefit)	483	(238)
Net Income (loss)	1,698	(248)
Dividends on preferred shares	194	74

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Net Income (loss) applicable to common shares	\$ 1,504	\$ (322)
Basic earnings per common share	\$ 0.20	\$ (0.04)
Diluted earnings per common share	\$ 0.18	\$ (0.04)

See Notes to Consolidated Financial Statements

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

Dollars in thousands	For the Three Months Ended	
	March 31,	
	2012	2011
Net income (loss)	\$ 1,698	\$ (248)
Other comprehensive income (loss):		
Non-credit related		
other-than-temporary impairment on		
available for sale debt securities -		
2012 - \$282, net of deferred		
taxes of \$107; 2011 - \$600, net of		
deferred taxes of \$228	(175)	(372)
Net unrealized gain on available for		
sale debt securities of:		
2012 - \$811 net of deferred taxes of \$308 and reclassification		
adjustment		
for net realized gains included in net income of \$1,165; 2011 - \$312, net		
of		
deferred taxes of \$118 and		
reclassification adjustment for net		
realized		
gains included in net income of		
\$1,628	503	194
Total comprehensive income (loss)	\$ 2,026	\$ (426)

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	Series 2009 Preferred Stock and Related Surplus	Series 2011 Preferred Stock and Related Surplus	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2011	\$ 3,519	\$ 5,807	\$ 24,518	\$ 64,904	\$ 3,818	\$ 102,566
Three Months Ended March 31, 2012						
Comprehensive income:						
Net income (loss)	-	-	-	1,698	-	1,698
Other comprehensive income					328	328
Total comprehensive income						2,026
Stock compensation expense	-	-	1	-	-	1
Series 2009 Preferred Stock cash dividends declared (\$20.00 per share)	-	-	-	(74)	-	(74)
Series 2011 Preferred Stock cash dividends declared (\$20.00 per share)	-	-	-	(120)	-	(120)
Balance, March 31, 2012	\$ 3,519	\$ 5,807	\$ 24,519	\$ 66,408	\$ 4,146	\$ 104,399
Balance, December 31, 2010	\$ 3,519	\$ -	\$ 24,508	\$ 61,201	\$ 593	\$ 89,821
Three Months Ended March 31, 2011						
Comprehensive income (loss):						
Net income (loss)	-	-	-	(248)	-	(248)
Other comprehensive income (loss)					(178)	(178)
Total comprehensive income (loss)						(426)
Stock compensation expense	-	-	7	-	-	7
Preferred stock cash dividends declared (\$20.00 per share)	-	-	-	(74)	-	(74)
Balance, March 31, 2011	\$ 3,519	\$ -	\$ 24,515	\$ 60,879	\$ 415	\$ 89,328

See Notes to Consolidated
Financial Statements

7

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

Dollars in thousands	Three Months Ended	
	March 31, 2012	March 31, 2011
Cash Flows from Operating Activities		
Net income (loss)	\$ 1,698	\$ (248)
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	339	362
Provision for loan losses	2,001	3,000
Stock compensation expense	1	7
Deferred income tax (benefit)	(688)	(1,630)
Loans originated for sale	(2,884)	(2,715)
Proceeds from loans sold	1,758	2,656
(Gain) on loans sold	-	-
Securities (gains)	(1,165)	(1,628)
Other-than-temporary impairment of securities	229	1,228
(Gain) loss on disposal of assets	77	(71)
Write down of foreclosed properties	1,912	3,443
Amortization of securities premiums (accretion of discounts), net	858	373
Amortization of goodwill and purchase accounting adjustments, net	91	91
Decrease in accrued interest receivable	516	82
(Increase) in cash surrender value of bank owned life insurance	(275)	(131)
(Increase) in other assets	(815)	(842)
Increase (decrease) in other liabilities	922	(665)
Net cash provided by operating activities	4,575	3,312
Cash Flows from Investing Activities		
Proceeds from (purchase of) interest bearing deposits with other banks	1,438	(752)
Proceeds from maturities and calls of securities available for sale	803	2,889
Proceeds from sales of securities available for sale	25,632	13,256
Principal payments received on securities available for sale	14,501	17,311
Purchases of securities available for sale	(45,733)	(55,226)
Redemption of Federal Home Loan Bank Stock	805	986
Net principal payments received on loans	5,051	11,225

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Purchases of premises and equipment	(12)	(54)
Proceeds from sales of other repossessed assets & property held for sale	1,243	1,855
Net cash provided by (used in) investing activities	3,728	(8,510)
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and savings accounts	16,877	50,571
Net (decrease) in time deposits	(22,238)	(25,391)
Net increase in short-term borrowings	1	296
Repayment of long-term borrowings	(3,133)	(20,593)
Dividends paid on preferred stock	(149)	(74)
Net cash provided by (used in) financing activities	(8,642)	4,809
(Decrease) in cash and due from banks	(339)	(389)
Cash and due from banks:		
Beginning	4,398	4,652
Ending	\$ 4,059	\$ 4,263

(Continued)

See Notes to Consolidated Financial Statements

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

Dollars in thousands	Three Months Ended	
	March 31, 2012	March 31, 2011
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	\$6,944	\$8,311
Income taxes	\$159	\$-
Supplemental Schedule of Noncash Investing and Financing Activities		
Other assets acquired in settlement of loans	\$1,087	\$1,707

See Notes to Consolidated Financial Statements

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.

The results of operations for the quarter ended March 31, 2012 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 2011 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2011 and March 31, 2011, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

ASU No. 2011-03, Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreement is intended to improve financial reporting of repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 removes from the assessment of effective control (i) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (ii) the collateral maintenance guidance related to that criterion. ASU 2011-03 was effective for us on January 1, 2012 and did not have a significant impact on our financial statements.

ASU 2011-04, Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs amends Topic 820, Fair Value Measurements and Disclosures, to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on our financial statements.

ASU 2011-05, Comprehensive Income (Topic 220) - Presentation of Comprehensive Income amends Topic 220, Comprehensive Income, to require that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. ASU 2011-05 is effective for annual periods beginning after December 15, 2011, and is not expected to have a

significant impact on our financial statements.

ASU 2011-08, Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment, amends Topic 350, Intangibles – Goodwill and Other, to permit entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-than-likely-than-not threshold is defined as having a likelihood of more than 50 percent. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit.

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

If the carrying amount of the reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of impairment loss, if any. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and is not expected to have a significant impact on our financial statements.

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 March 31, 2012, 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 March 31, 2012, the appraised values of the underlying collateral for our collateral-dependent impaired loans which had a related specific allowance or prior charge-off was in excess of the total fair value by \$10,600,000.

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.

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.

Dollars in thousands	Balance at March 31, 2012	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	\$ 10,180	\$ -	\$ 10,180	\$ -
Mortgage backed securities:				
Government sponsored agencies	164,838	-	164,838	-
Nongovernment sponsored agencies	31,940	-	31,940	-
State and political subdivisions	5,624	-	5,624	-
Corporate debt securities	1,862	-	1,862	-
Other equity securities	77	-	77	-
	74,444	-	74,444	-

Tax-exempt state and political
subdivisions

Tax-exempt mortgage-backed securities	3,037	-	3,037	-
Total available for sale securities	\$ 292,002	\$ -	\$ 292,002	\$ -

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

Dollars in thousands	Balance at December 31, 2011	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	\$ 8,747	\$ -	\$ 8,747	\$ -
Mortgage backed securities:				
Government sponsored agencies	155,505	-	155,505	-
Nongovernment sponsored agencies	34,428	-	34,428	-
State and political subdivisions	4,571	-	4,571	-
Corporate debt securities	817	-	817	-
Other equity securities	77	-	77	-
Tax-exempt state and political subdivisions	79,326	-	79,326	-
Tax-exempt mortgage backed securities	3,128	-	3,128	-
Total available for sale securities	\$ 286,599	\$ -	\$ 286,599	\$ -

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended March 31, 2012.

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.

Dollars in thousands	Total at March 31, 2012	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 1,126	\$ -	\$ 1,126	\$ -
Impaired loans				
Commercial	\$ 2,795	\$ -	\$ -	\$ 2,795
Commercial real estate	23,783	-	14,992	8,791
Construction and development	33,648	-	29,638	4,010
Residential real estate	24,758	-	17,277	7,481
Consumer	328	-	286	42
Total impaired loans	\$ 85,312	\$ -	\$ 62,193	\$ 23,119

OREO				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial real estate	14,703	-	14,703	-
Construction and development	43,101	-	42,426	675
Residential real estate	3,780	-	3,780	-
Consumer	-	-	-	-
Total OREO	\$ 61,584	\$ -	\$ 60,909	\$ 675

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

Dollars in thousands	Total at December 31, 2011	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ -	\$ -	\$ -	\$ -
Impaired loans				
Commercial	\$ 2,722	\$ -	\$ -	\$ 2,722
Commercial real estate	21,148	-	13,777	7,371
Construction and development	27,667	-	25,297	2,370
Residential real estate	22,768	-	18,253	4,515
Consumer	6	-	-	6
Total impaired loans	\$ 74,311	\$ -	\$ 57,327	\$ 16,984
OREO				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial real estate	15,721	-	15,721	-
Construction and development	44,978	-	44,303	675
Residential real estate	3,239	-	3,239	-
Consumer	-	-	-	-
Total OREO	\$ 63,938	\$ -	\$ 63,263	\$ 675

Impaired loans, which are measured for impairment primarily using the fair value of the collateral for collateral-dependent loans, had a carrying amount at March 31, 2012 of \$91,022,000, with a valuation allowance of \$5,710,000, resulting in additional provision for loan losses of \$1,233,000 for the three months ended March 31, 2012.

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 carrying values of interest bearing deposits with other banks approximate their estimated fair values.

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.

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

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.

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:

Dollars in thousands	March 31, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and due from banks	\$ 4,059	\$ 4,059	\$ 4,398	\$ 4,398
Interest bearing deposits with				
other banks	26,855	26,855	28,294	28,294
Securities available for sale	292,002	292,002	286,599	286,599
Other investments	18,342	18,342	19,146	19,146
Loans held for sale, net	1,126	1,126	-	-
Loans, net	957,797	974,633	965,516	977,782
Accrued interest receivable	5,269	5,269	5,784	5,784
	\$ 1,305,450	\$ 1,322,286	\$ 1,309,737	\$ 1,322,003
Financial liabilities				
Deposits	\$ 1,011,139	\$ 1,051,475	\$ 1,016,500	\$ 1,054,093
Short-term borrowings	15,956	15,956	15,956	15,956
Long-term borrowings	267,121	285,886	270,254	291,099
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	2,393	2,393	2,558	2,558
	\$ 1,332,998	\$ 1,392,099	\$ 1,341,657	\$ 1,400,095

NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

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

Dollars in thousands, except per share amounts	For the Three Months Ended March 31,					
	2012	Common			2011	Common
	Income	Shares	Per	Income	Shares	Per
	(Numerator)	(Denominator)	Share	(Numerator)	(Denominator)	Share
Net income	\$ 1,698			\$ (248)		
Less preferred stock dividends	(194)			(74)		
Basic EPS	\$ 1,504	7,425,472	\$ 0.20	\$ (322)	7,425,472	\$ (0.04)
Effect of dilutive securities:						
Stock options	-	-		-	-	
Series 2009 convertible preferred stock	74	674,545		-	-	
Series 2011 convertible preferred stock	120	1,500,000		-	-	
Diluted EPS	\$ 1,698	9,600,017	\$ 0.18	\$ (322)	7,425,472	\$ (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 March 31, 2012 and 2011 totaled 289,380 shares and 312,180 shares, respectively. Our anti-dilutive convertible preferred stock totaled 674,545 shares at March 31, 2011.

NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at March 31, 2012, December 31, 2011, and March 31, 2011 are summarized as follows:

Dollars in thousands Available for Sale	Amortized Cost	March 31, 2012		Estimated Fair Value
		Gains	Losses	
Taxable debt securities:				

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

U. S. Government agencies and corporations	\$ 9,721	\$ 475	\$ 16	\$ 10,180
Residential mortgage-backed securities:				
Government-sponsored agencies	161,928	3,435	525	164,838
Nongovernment-sponsored agencies	32,028	627	715	31,940
State and political subdivisions	5,661	-	37	5,624
Corporate debt securities	1,947	12	97	1,862
Total taxable debt securities	211,285	4,549	1,390	214,444
Tax-exempt debt securities:				
State and political subdivisions	70,913	3,837	306	74,444
Residential mortgage-backed securities:				
Government-sponsored agencies	3,037	-	-	3,037
Total tax-exempt debt securities	73,950	3,837	306	77,481
Equity securities	77	-	-	77
Total available for sale securities	\$ 285,312	\$ 8,386	\$ 1,696	\$ 292,002

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

Dollars in thousands	Amortized Cost	December 31, 2011		Estimated Fair Value
		Gains	Losses	
Available for Sale				
Taxable debt securities				
U. S. Government agencies and corporations	\$ 8,262	\$ 495	\$ 10	\$ 8,747
Residential mortgage-backed securities:				
Government-sponsored agencies	152,815	3,460	770	155,505
Nongovernment-sponsored entities	35,246	742	1,560	34,428
State and political subdivisions	4,559	16	4	4,571
Corporate debt securities	999	-	182	817
Total taxable debt securities	201,881	4,713	2,526	204,068
Tax-exempt debt securities				
State and political subdivisions	75,371	3,986	31	79,326
Residential mortgage-backed securities	3,109	19	-	3,128
Total tax-exempt debt securities	78,480	4,005	31	82,454
Equity securities	77	-	-	77
Total available for sale securities	\$ 280,438	\$ 8,718	\$ 2,557	\$ 286,599

Dollars in thousands	Amortized Cost	March 31, 2011		Estimated Fair Value
		Gains	Losses	
Available for Sale				
Taxable debt securities:				
U. S. Government agencies and corporations	\$ 31,530	\$ 217	\$ 358	\$ 31,389
Residential mortgage-backed securities:				
Government-sponsored agencies	143,883	2,751	408	146,226
Nongovernment-sponsored agencies	52,516	1,890	1,866	52,540
State and political subdivisions	23,324	21	1,177	22,168
Corporate debt securities	999	-	34	965
Total taxable debt securities	252,252	4,879	3,843	253,288
Tax-exempt debt securities:				
State and political subdivisions	40,238	273	636	39,875
Total tax-exempt debt securities	40,238	273	636	39,875

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Equity securities	77	-	-	77
Total available for sale securities	\$ 292,567	\$ 5,152	\$ 4,479	\$ 293,240

The maturities, amortized cost and estimated fair values of securities at March 31, 2012, are summarized as follows:

Dollars in thousands	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 71,605	\$ 72,852
Due from one to five years	91,493	93,316
Due from five to ten years	19,918	20,136
Due after ten years	102,219	105,621
Equity securities	77	77
	\$ 285,312	\$ 292,002

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

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 three months ended March 31, 2012 are as follows:

Dollars in thousands	Sales	Proceeds from	Principal	Gross realized	
		Calls and Maturities	Payments	Gains	Losses
Securities available for sale	\$ 25,632	\$ 803	\$ 14,501	\$ 1,166	\$ 1

During the three months ended March 31, 2012 and 2011, we recorded other-than-temporary impairment losses on residential mortgage-backed nongovernment sponsored entity securities as follows:

Dollars in thousands	Three Months Ended	
	March 31,	
	2012	2011
Total other-than-temporary impairment losses	\$ (511)	\$ (1,828)
Portion of loss recognized in other comprehensive income	282	600
Net impairment losses recognized in earnings	\$ (229)	\$ (1,228)

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 ended March 31, 2012 is as follows:

Dollars in thousands	Three
	Months Ended
	March 31, 2012
Beginning Balance	\$ (6,355)
Additions for the credit component on debt	

securities in which other-than-temporary impairment was not previously recognized	(229)
Securities sold during the period	-
Ending Balance	\$ (6,584)

At March 31, 2012, 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 March 31, 2012:

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

	Weighted Average	Range Minimum	Maximum
Constant voluntary prepayment rates	8.1 %	2.7 %	21.2 %
Constant default rates	5.7 %	3.9 %	7.7 %
Loss severities	48.0 %	40.0 %	52.0 %

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 March 31, 2012 and December 31, 2011, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

Dollars in thousands	Less than 12 months		March 31, 2012 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	\$ 2,717	\$ (16)	\$ 117	\$ -	\$ 2,834	\$ (16)
Residential mortgage-backed securities:						
Government-sponsored agencies	61,078	(525)	-	-	61,078	(525)
Nongovernment-sponsored entities	3,619	(103)	1,468	(121)	5,087	(224)
State and political subdivisions	2,238	(33)	386	(4)	2,624	(37)
Corporate debt securities	-	-	902	(97)	902	(97)
Tax-exempt debt securities						
State and political subdivisions	11,324	(306)	-	-	11,324	(306)
Total temporarily impaired securities	80,976	(983)	2,873	(222)	83,849	(1,205)

Other-than-temporarily
impaired securities

Taxable debt securities						
Residential						
mortgage-backed securities:						
Nongovernment-sponsored						
entities	218	(67)	6,473	(424)	6,691	(491)
Total other-than-temporarily						
impaired securities	218	(67)	6,473	(424)	6,691	(491)
Total	\$ 81,194	\$ (1,050)	\$ 9,346	\$ (646)	\$ 90,540	\$ (1,696)

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

Dollars in thousands	Less than 12 months		December 31, 2011 12 months or more		Total	
	Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized
	Fair Value	Loss	Fair Value	Loss	Fair Value	Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$ 1,074	\$ (10)	\$ 120	\$ -	\$ 1,194	\$ (10)
Residential						
mortgage-backed securities:						
Government-sponsored						
agencies	55,678	(770)	-	-	55,678	(770)
Nongovernment-sponsored						
entities	5,558	(158)	4,245	(239)	9,803	(397)
State and political						
subdivisions	-	-	-	-	-	-
Corporate debt securities	-	-	817	(182)	817	(182)
Tax-exempt debt securities						
State and political						
subdivisions	1,418	(29)	1,132	(6)	2,550	(35)
Total temporarily impaired						
securities	63,728	(967)	6,314	(427)	70,042	(1,394)
Other-than-temporarily						
impaired securities						
Taxable debt securities						
Residential						
mortgage-backed securities:						
Nongovernment-sponsored						
entities	466	(261)	5,638	(902)	6,104	(1,163)
Total other-than-temporarily						
impaired securities	466	(261)	5,638	(902)	6,104	(1,163)
Total	\$ 64,194	\$ (1,228)	\$ 11,952	\$ (1,329)	\$ 76,146	\$ (2,557)

We held 80 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 March 31, 2012. 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 March 31, 2012, we had \$715,000 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. 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:

Dollars in thousands	March 31, 2012	December 31, 2011	March 31, 2011
Commercial	\$ 99,386	\$ 99,024	\$ 92,227
Commercial real estate			
Owner-occupied	153,528	158,754	182,956
Non-owner occupied	275,727	270,226	240,604
Construction and development			
Land and land development	88,212	93,035	93,675
Construction	2,148	2,936	13,879
Residential real estate			
Non-jumbo	219,485	221,733	233,308
Jumbo	62,836	61,535	61,878
Home equity	50,884	50,898	50,499
Consumer	21,574	22,325	22,968
Other	2,540	2,762	4,326
Total loans, net of unearned fees	976,320	983,228	996,320
Less allowance for loan losses	18,523	17,712	16,933
Loans, net	\$ 957,797	\$ 965,516	\$ 979,387

The following table presents the contractual aging of the recorded investment in past due loans by class as of March 31, 2012 and 2011 and December 31, 2011.

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

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

At March 31, 2012

Dollars in thousands	30-59 days	Past Due		Total	Current	Recorded Investment > 90 days and Accruing
		60-89 days	> 90 days			
Commercial	\$ 893	\$ 37	\$ 2,234	\$ 3,164	\$ 96,222	\$ -
Commercial real estate						
Owner-occupied	1,007	412	955	2,374	151,154	-
Non-owner occupied	1,411	-	1,928	3,339	272,388	-
Construction and development						
Land and land development	375	1,960	13,906	16,241	71,971	-
Construction	-	-	887	887	1,261	-
Residential mortgage						
Non-jumbo	2,679	2,409	2,863	7,951	211,534	-
Jumbo	1,337	-	12,621	13,958	48,878	-
Home equity	-	335	55	390	50,494	-
Consumer	156	103	26	285	21,289	-
Other	-	-	-	-	2,540	-
Total	\$ 7,858	\$ 5,256	\$ 35,475	\$ 48,589	\$ 927,731	\$ -

At December 31, 2011

Dollars in thousands	30-59 days	Past Due		Total	Current	Recorded Investment > 90 days and Accruing
		60-89 days	> 90 days			
Commercial	\$ 904	\$ 324	\$ 2,544	\$ 3,772	\$ 95,252	\$ -
Commercial real estate						
Owner-occupied	4,241	197	664	5,102	153,652	-
Non-owner occupied	1,566	1,752	1,705	5,023	265,203	-
Construction and development						

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Land and land development	1,539	116	16,392	18,047	74,988	344
Construction	106	-	979	1,085	1,851	-
Residential mortgage						
Non-jumbo	4,730	1,624	2,336	8,690	213,043	-
Jumbo	699	-	13,965	14,664	46,871	-
Home equity	-	223	91	314	50,584	-
Consumer	381	144	85	610	21,715	-
Other	-	-	-	-	2,762	-
Total	\$ 14,166	\$ 4,380	\$ 38,761	\$ 57,307	\$ 925,921	\$ 344

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

Dollars in thousands	Past Due			Total	Current	Recorded Investment > 90 days and Accruing
	30-59 days	60-89 days	> 90 days			
Commercial	\$ 906	\$ 4	\$ 2,142	\$ 3,052	\$ 89,175	\$ -
Commercial real estate						
Owner-occupied	72	473	2,765	3,310	179,646	-
Non-owner occupied	1,916	53	1,421	3,390	237,214	-
Construction and development						
Land and land development	1,773	124	8,358	10,255	83,420	-
Construction	-	51	150	201	13,678	-
Residential mortgage						
Non-jumbo	5,229	1,184	3,889	10,302	223,006	-
Jumbo	-	-	927	927	60,951	-
Home equity	148	-	74	222	50,277	-
Consumer	406	77	143	626	22,342	-
Other	8	3	9	19	4,307	9
Total	\$ 10,458	\$ 1,969	\$ 19,878	\$ 32,304	\$ 964,016	\$ 9

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at March 31, 2012, December 31, 2011 and March 31, 2011.

Dollars in thousands	3/31/2012	12/31/2011	3/31/2011
Commercial	\$ 2,477	\$ 3,260	\$ 2,186
Commercial real estate			
Owner-occupied	1,989	2,815	3,785
Non-owner occupied	2,293	4,348	1,499
Construction and development			
Land & land development	21,287	22,362	8,358
Construction	887	979	201
Residential mortgage			
Non-jumbo	4,583	3,683	4,908

Jumbo	12,621	13,966	927
Home equity	550	538	508
Consumer	81	145	197
Other	-	-	-
Total	\$ 46,768	\$ 52,096	\$ 22,569

Impaired loans: Impaired loans include the following:

§ Loans which we risk-rate (consisting of loan relationships having aggregate balances in excess of \$2,000,000, or loans exceeding \$500,000 and exhibiting credit weakness) through our normal loan review procedures and which, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement. Risk-rated loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired.

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

§ Loans that have been modified in a troubled debt restructuring.

Both commercial and consumer loans are deemed impaired upon being contractually modified in a troubled debt restructuring. Troubled debt restructurings typically result from our loss mitigation activities and occur when we grant a concession to a borrower who is experiencing financial difficulty in order to minimize our economic loss and to avoid foreclosure or repossession of collateral. Once restructured in a troubled debt restructuring, a loan is generally considered impaired until its maturity, regardless of whether the borrower performs under the modified terms. Although such a loan may be returned to accrual status if the criteria set forth in our accounting policy are met, the loan would continue to be evaluated for an asset-specific allowance for loan losses and we would continue to report the loan in the impaired loan table below.

The table below sets forth information about our impaired loans.

Loan Category	03/31/2012	12/31/2011	03/31/2011	Method used to measure impairment
Commerical	\$ 2,998	\$ 2,969	\$ 1,436	Fair value of collateral
Commerical real estate				
Owner-occupied	11,263	9,698	8,393	Fair value of collateral
	2,724	2,580	2,618	Discounted cash flow
Non-owner occupied	10,375	9,790	4,455	Fair value of collateral
	-	-	530	Discounted cash flow
Construction and development				
Land & land development	35,746	29,862	22,130	Fair value of collateral
	656	-	-	Discounted cash flow
Construction	735	735	92	Fair value of collateral
Residential mortgage				
Non-jumbo	4,692	4,488	5,906	Fair value of collateral
	1,252	372	577	Discounted cash flow
Jumbo	19,899	18,147	15,401	Fair value of collateral

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Home equity	353	407	210	Fair value of collateral
Consumer	329	8	-	Fair value of collateral
Total	\$ 91,022	\$ 79,056	\$ 61,748	

The following tables present loans individually evaluated for impairment at March 31, 2012, December 31, 2011 and March 31, 2011.

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

Dollars in thousands	March 31, 2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 2,307	\$ 2,306	\$ -	\$ 1,697	\$ 30
Commercial real estate					
Owner-occupied	11,036	11,045	-	9,004	335
Non-owner occupied	6,307	6,308	-	6,046	305
Construction and development					
Land & land development	18,732	18,732	-	10,920	334
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	3,876	3,886	-	3,139	99
Jumbo	15,661	15,662	-	14,621	200
Home equity	191	191	-	191	11
Consumer	293	293	-	11	1
Total without a related allowance	\$ 58,403	\$ 58,423	\$ -	\$ 45,629	\$ 1,315
With a related allowance					
Commercial	\$ 692	\$ 692	\$ 203	\$ 692	\$ 4
Commercial real estate					
Owner-occupied	2,941	2,942	140	2,942	141
Non-owner occupied	4,065	4,067	439	3,366	116
Construction and development					
Land & land development	17,667	17,670	3,070	16,148	65
Construction	735	735	419	-	-
Residential real estate					
Non-jumbo	2,056	2,058	574	892	34
Jumbo	4,227	4,237	753	2,243	1

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Home equity	162	162	111	162	-
Consumer	36	36	1	-	-
Total with a related allowance	\$ 32,581	\$ 32,599	\$ 5,710	\$ 26,445	\$ 361
Total					
Commercial	\$ 64,482	\$ 64,497	\$ 4,271	\$ 50,815	\$ 1,330
Residential real estate	26,173	26,196	1,438	21,248	- 345
Consumer	329	329	1	11	1
Total	\$ 90,984	\$ 91,022	\$ 5,710	\$ 72,074	\$ 1,676

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

Dollars in thousands	December 31, 2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 2,074	\$ 2,076	\$ -	\$ 874	\$ 10
Commercial real estate					
Owner-occupied	9,013	9,034	-	8,132	253
Non-owner occupied	5,599	5,600	-	2,891	116
Construction and development					
Land & land development	12,128	12,128	-	9,509	346
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	3,697	3,708	-	2,843	68
Jumbo	15,203	15,204	-	12,626	-
Home equity	194	194	-	99	6
Total without a related allowance	\$ 47,908	\$ 47,944	\$ -	\$ 36,974	\$ 799
With a related allowance					
Commercial	\$ 893	\$ 893	\$ 247	\$ 661	\$ 1
Commercial real estate					
Owner-occupied	3,244	3,244	465	3,588	143
Non-owner occupied	4,190	4,190	456	3,357	87
Construction and development					
Land & land development	17,719	17,734	2,901	8,726	40
Construction	735	735	29	2	-
Residential real estate					
Non-jumbo	1,150	1,152	209	706	31
Jumbo	2,943	2,943	275	1,349	-
Home equity	213	213	162	125	2

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Consumer	8	8	1	-	-
Total with a related allowance	\$ 31,095	\$ 31,112	\$ 4,745	\$ 18,514	\$ 304
Total					
Commercial	\$ 55,595	\$ 55,634	\$ 4,098	\$ 37,740	\$ 996
Residential real estate	23,400	23,414	646	17,748	- 107
Consumer	8	8	1	-	-
Total	\$ 79,003	\$ 79,056	\$ 4,745	\$ 55,488	\$ 1,103

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

Dollars in thousands	March 31, 2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 1,422	\$ 1,423	\$ -	\$ 215	\$ 1
Commercial real estate					
Owner-occupied	7,049	7,068	-	1,761	12
Non-owner occupied	1,637	1,638	-	728	8
Construction and development					
Land & land development	19,217	19,217	-	5,417	16
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	4,055	4,077	-	2,439	19
Jumbo	13,128	13,129	-	4,376	75
Home equity	-	-	-	-	-
Total without a related allowance	\$ 46,508	\$ 46,552	\$ -	\$ 14,936	\$ 131
With a related allowance					
Commercial	\$ 14	\$ 14	\$ 14	\$ -	\$ -
Commercial real estate					
Owner-occupied	3,943	3,943	280	2,198	12
Non-owner occupied	3,341	3,347	470	721	7
Construction and development					
Land & land development	2,912	2,912	1,160	2,352	3
Construction	92	92	5	1	-
Residential real estate					
Non-jumbo	2,404	2,406	681	718	6
Jumbo	2,272	2,272	448	757	-
Home equity	210	210	210	178	-

Total with a related allowance	\$ 15,188	\$ 15,196	\$ 3,268	\$ 6,925	\$ 28
Total					
Commercial	\$ 39,627	\$ 39,654	\$ 1,929	\$ 13,393	\$ 59
Residential real estate	22,069	22,094	1,339	8,468	- 100
Total	\$ 61,696	\$ 61,748	\$ 3,268	\$ 21,861	\$ 159

A modification of a loan is considered a troubled debt restructuring (“TDR”) when a borrower is experiencing financial difficulty and the modification constitutes a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of both. A loan continues to qualify as a TDR until a consistent payment history or change in the borrower’s financial condition has been evidenced, generally no less than twelve months. Included in impaired loans are TDRs of \$47,837,000 and \$47,770,000 at March 31, 2012 and December 31, 2011, respectively, with no commitments to lend additional funds under these restructurings at either balance sheet date.

The following table presents by class the TDRs that were restructured during the three months ended March 31, 2012. Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes.

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

dollars in thousands	For the Three Months Ended March 31, 2012		
	Number of Modifications	Pre-modification	Post-modification
		Recorded Investment	Recorded Investment
Commercial	2	\$ 1,031	\$ 1,039
Commercial real estate			
Owner-occupied	-	-	-
Non-owner occupied	1	336	350
Construction and development			
Land & land development	-	-	-
Construction	-	-	-
Residential real estate			
Non-jumbo	1	60	62
Jumbo	-	-	-
Home equity	-	-	-
Consumer	1	38	38
Total	5	\$ 1,465	\$ 1,489

The following table presents defaults during the stated period of TDRs that were restructured during the past twelve months. For purposes of these tables, a default is considered as either the loan was past due 30 days or more at any time during the period, or the loan was fully or partially charged off during the period.

dollars in thousands	For the Three Months Ended March 31, 2012	
	Number of Defaults	Recorded Investment at Default Date
	Commercial	-
Commercial real estate		
Owner-occupied	1	521
Non-owner occupied	-	-

Construction and development		
Land & land development	2	1,191
Construction	-	-
Residential real estate		
Non-jumbo	1	258
Jumbo	3	4,727
Home equity	-	-
Consumer	-	-
Total	7	\$ 6,697

We categorize loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We analyze loans individually by classifying the loans as to credit risk. We internally grade all commercial loans at the time of loan origination. In addition, we perform an annual loan review on all non-homogenous commercial loan relationships with an aggregate exposure of \$2 million, at which time these loans are re-graded. We use the following definitions for our risk grades:

Pass: Loans graded as Pass are loans to borrowers of acceptable credit quality and risk. They are higher quality loans that do not fit any of the other categories described below.

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

OLEM (Special Mention): Commercial loans categorized as OLEM are potentially weak. The credit risk may be relatively minor yet represent a risk given certain specific circumstances. If the potential weaknesses are not monitored or mitigated, the asset may weaken or inadequately protect our position in the future.

Substandard: Commercial loans categorized as Substandard are inadequately protected by the borrower's ability to repay, equity, and/or the collateral pledged to secure the loan. These loans have identified weaknesses that could hinder normal repayment or collection of the debt. These loans are characterized by the distinct possibility that we will sustain some loss if the identified weaknesses are not mitigated.

Doubtful: Commercial loans categorized as Doubtful have all the weaknesses inherent in those loans classified as Substandard, with the added elements that the full collection of the loan is improbable and the possibility of loss is high.

Loss: Loans classified as loss are considered to be non-collectible and of such little value that their continuance as a bankable asset is not warranted. This does not mean that the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future.

Loan Risk Profile by Internal
Risk Rating

	Construction and Development				Commercial Real Estate					
	Land and land development		Construction	Commercial	Owner Occupied		Non-Owner Occupied			
Dollars in thousands	3/31/2012	12/31/2011	3/31/2012	12/31/2011	3/31/2012	12/31/2011	3/31/2012	12/31/2011	3/31/2012	12/31/2011
Pass	\$44,723	\$47,521	\$1,261	\$1,886	\$85,626	\$84,225	\$138,422	\$143,845	\$258,250	\$253,319
OLEM (Special Mention)	8,305	18,615	-	-	6,398	6,889	4,157	5,474	12,231	10,421
Substandard	35,184	26,899	887	1,049	7,362	7,910	10,949	9,435	5,246	6,486
Doubtful	-	-	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-	-	-
Total	\$88,212	\$93,035	\$2,148	\$2,935	\$99,386	\$99,024	\$153,528	\$158,754	\$275,727	\$270,226

The following table presents the recorded investment in consumer, residential real estate, and home equity loans, which are generally evaluated based on the aging status of the loans, which was previously presented, and payment activity.

Dollars in thousands	Performing			Nonperforming		
	3/31/2012	12/31/2011	3/31/2011	3/31/2012	12/31/2011	3/31/2011
Residential real estate						
Non-jumbo	\$ 214,902	\$ 218,050	\$ 228,400	\$ 4,583	\$ 3,683	\$ 4,908
Jumbo	50,215	47,570	60,951	12,621	13,965	927

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Home						
Equity	50,334	50,360	49,991	550	538	508
Consumer	21,493	22,180	22,771	81	145	197
Other	2,540	2,762	4,326	-	-	-
Total	\$ 339,484	\$ 340,922	\$ 366,439	\$ 17,835	\$ 18,331	\$ 6,540

Loan commitments: ASC Topic 815, Derivatives and Hedging, requires that commitments to make mortgage loans should be accounted for as derivatives if the loans are to be held for sale, because the commitment represents a written option and accordingly is recorded at the fair value of the option liability.

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

NOTE 7. ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses for the three month periods ended March 30, 2012 and 2011, and for the year ended December 31, 2011 is as follows:

Dollars in thousands	Three Months Ended		Year
	2012	March 31, 2011	Ended December 31, 2011
Balance, beginning of year	\$ 17,712	\$ 17,224	\$ 17,224
Losses:			
Commercial	31	1,827	506
Commercial real estate			
Owner occupied	283	-	508
Non-owner occupied	395	-	78
Construction and development			
Land and land development			
Construction	365	-	3,568
Residential real estate			
Non-jumbo	126	860	3,178
Jumbo	87	643	1,511
Home equity	-	-	346
Consumer	32	55	162
Other	20	10	86
Total	1,339	3,395	9,943
Recoveries:			
Commercial	2	28	35
Commercial real estate			
Owner occupied	3	-	37
Non-owner occupied	8	9	55
Construction and development			
Land and land development			
Construction	5	2	43
Real estate - mortgage			
Non-jumbo	19	11	83
Jumbo	9	1	14

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Home equity	60	1	1
Consumer	14	50	112
Other	29	2	51
Total	149	104	431
Net losses	1,190	3,291	9,512
Provision for loan losses	2,001	3,000	10,000
Balance, end of year	\$ 18,523	\$ 16,933	\$ 17,712

Activity in the allowance for loan losses by loan class during the first three months of 2012 is as follows:

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

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

Dollars in thousands	Construction & Land Development			Commercial Real Estate		Residential Real Estate				Other	Total
	Land & Land Development	Construction	Commercial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Consumer		
Allowance for loan losses											
Beginning balance	\$7,261	\$120	\$770	\$1,335	\$3,283	\$2,587	\$1,331	\$831	\$161	\$33	\$17,712
Charge-offs	365	-	31	283	395	126	87	-	32	20	1,339
Recoveries	5	-	2	3	8	19	9	60	14	29	149
Provision	242	368	(2)	5	485	274	733	(83)	(6)	(15)	2,001
Ending balance	\$7,143	\$488	\$739	\$1,060	\$3,381	\$2,754	\$1,986	\$808	\$137	\$27	\$18,523
Allowance related to:											
Loans individually evaluated for impairment											
	\$3,070	\$418	\$203	\$140	\$439	\$574	\$753	\$111	\$2	\$-	\$5,710
Loans collectively evaluated for impairment											
	4,073	70	536	920	2,942	2,180	1,233	697	135	27	12,813
Loans acquired with deteriorated credit quality											
	-	-	-	-	-	-	-	-	-	-	-
Total	\$7,143	\$488	\$739	\$1,060	\$3,381	\$2,754	\$1,986	\$808	\$137	\$27	\$18,523
Loans individually evaluated for impairment											
	\$36,402	\$735	\$2,998	\$13,986	\$14,585	\$5,944	\$15,689	\$353	\$330	\$-	\$91,022
Loans collectively											
	51,810	1,413	96,388	139,542	261,142	213,541	47,147	50,531	21,244	2,540	\$885,298

evaluated
for
impairment
Loans
acquired with
deteriorated
credit quality

	-	-	-	-	-	-	-	-	-	-	-
Total	\$88,212	\$2,148	\$99,386	\$153,528	\$275,727	\$219,485	\$62,836	\$50,884	\$21,574	\$2,540	\$976,320

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 March 31, 2012 and other intangible assets by reporting unit at March 31, 2012 and December 31, 2011.

Goodwill Activity			
Community Insurance			
Dollars in thousands	Banking	Services	Total
Balance, January 1, 2012	\$ 1,488	\$ 4,710	\$ 6,198
Acquired goodwill, net	-	-	-
Balance, March 31, 2012	\$ 1,488	\$ 4,710	\$ 6,198

Other Intangible Assets						
Dollars in thousands	March 31, 2012			December 31, 2011		
	Banking	Services	Total	Banking	Services	Total
Unidentifiable intangible assets						
Gross carrying amount	\$ 2,267	\$ -	\$ 2,267	\$ 2,267	\$ -	\$ 2,267
Less: accumulated amortization	1,952	-	1,952	1,914	-	1,914
Net carrying amount	\$ 315	\$ -	\$ 315	\$ 353	\$ -	\$ 353
Identifiable intangible assets						
Gross carrying amount	\$ -	\$ 3,000	\$ 3,000	\$ -	\$ 3,000	\$ 3,000
Less: accumulated amortization	-	950	950	-	900	900
Net carrying amount	\$ -	\$ 2,050	\$ 2,050	\$ -	\$ 2,100	\$ 2,100

We recorded amortization expense of approximately \$88,000 for the three months ended March 31, 2012 relative to our other intangible assets. Annual amortization is expected to be approximately \$351,000 for each of the years ending 2012 through 2014.

NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of March 31, 2012 and 2011 and December 31, 2011:

Dollars in thousands	March 31, 2012	December 31, 2011	March 31, 2011
Demand deposits, interest bearing	\$ 172,506	\$ 158,483	\$ 153,283
Savings deposits	212,402	208,809	212,502
Retail time deposits	312,459	328,082	363,712
Wholesale deposits	225,856	232,471	245,887
Total	\$ 923,223	\$ 927,845	\$ 975,384

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

Wholesale deposits represent certificates of deposit acquired through a third party or bulletin board listing services on the internet.

A summary of the scheduled maturities for all time deposits as of March 31, 2012 is as follows:

Dollars in thousands	
Nine month period ending December 31, 2012	\$ 168,446
Year ending December 31, 2013	131,357
Year ending December 31, 2014	52,088
Year ending December 31, 2015	53,098
Year ending December 31, 2016	78,943
Thereafter	54,383
	\$ 538,315

The following is a summary of the maturity distribution of all certificates of deposit in denominations of \$100,000 or more as of March 31, 2012:

Dollars in thousands	Amount	Percent
Three months or less	\$ 37,350	10.2 %
Three through six months	19,854	5.4 %
Six through twelve months	61,822	16.9 %
Over twelve months	247,168	67.5 %
Total	\$ 366,194	100.0 %

NOTE 10. BORROWED FUNDS

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

33

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

Dollars in thousands	Three Months Ended March 31, 2012			
	Short-term FHLB Advances	Repurchase Agreements		Federal Funds Purchased and Lines of Credit
Balance at March 31	\$ 15,000	\$ -		\$ 956
Average balance outstanding for the period	13,379	-		956
Maximum balance outstanding at any month end during period	15,000	-		956
Weighted average interest rate for the period	0.17 %	0.00 %		0.25 %
Weighted average interest rate for balances outstanding at March 31	0.23 %	0.00 %		0.25 %

Dollars in thousands	Year Ended December 31, 2011			
	Short-term FHLB Advances	Short-Term Repurchase Agreements		Federal Funds Purchased and Lines of Credit
Balance at December 31	\$ 15,000	\$ -		\$ 956
Average balance outstanding for the period	2,753	531		954
Maximum balance outstanding at any month end during period	15,000	1,233		956
Weighted average interest rate for the period	0.17 %	0.15 %		0.25 %
Weighted average interest rate for balances outstanding at December 31	0.15 %	0.00 %		0.25 %

Three Months Ended March 31, 2011
Federal
Funds

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Dollars in thousands	Short-term FHLB Advances	Repurchase Agreements	Purchased and Lines of Credit
Balance at March 31	\$ -	\$ 925	\$ 954
Average balance outstanding for the period	-	781	953
Maximum balance outstanding at any month end during period	-	925	953
Weighted average interest rate for the period	0.00 %	0.15 %	0.25 %
Weighted average interest rate for balances outstanding at March 31	0.00 %	0.15 %	0.25 %

Long-term borrowings: Our long-term borrowings of \$267,121,000, \$270,254,000 and \$283,516,000 at March 31, 2012, December 31, 2011, and March 31, 2011 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.

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

	Balance at March 31,		Balance at December 31,
Dollars in thousands	2012	2011	2011
Long-term FHLB advances	\$ 157,643	\$ 162,233	\$ 160,325
Long-term reverse repurchase agreements	100,000	110,000	100,000
Term loan	9,478	11,283	9,929
Total	\$ 267,121	\$ 283,516	\$ 270,254

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 three month period ended March 31, 2012 was 3.97% compared to 4.15% for the first three months of 2011.

Subordinated debentures: We have subordinated debt totaling \$16.8 million at March 31, 2012, December 31, 2011, and March 31, 2011. The subordinated debt qualifies as Tier 2 capital under Federal Reserve Board guidelines until the debt is within 5 years of its maturity; thereafter the amount qualifying as Tier 2 capital is reduced by 20 percent each year until maturity. 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, and a term of 7.5 years.

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 March 31, 2012, December 31, 2011, and March 31, 2011.

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 each Capital Trust are redeemable by us quarterly.

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:

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

Dollars in thousands	Year Ending December	Long-term borrowings	Subordinated debentures	Subordinated debentures owed to unconsolidated subsidiary trusts
31,	2012	\$ 64,304	\$ -	\$ -
	2013	41,898	-	-
	2014	83,429	-	-
	2015	1,909	10,000	-
	2016	1,911	-	-
	Thereafter	73,670	6,800	19,589
		\$ 267,121	\$ 16,800	\$ 19,589

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.

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 no options granted during the first three months of 2012 or 2011.

We recognize compensation expense based on the estimated number of stock awards expected to actually vest, exclusive of the awards expected to be forfeited. During the first three months of 2012 and 2011, our stock compensation expense and related deferred taxes were insignificant.

A summary of activity in our Plans during the first three months of 2012 and 2011 is as follows:

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

	For the Three Months Ended March 31,			
	2012		2011	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, January 1	317,180	\$ 18.17	317,180	\$ 18.17
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Expired	(22,800)	5.12	-	-
Outstanding, March 31	294,380	\$ 19.18	317,180	\$ 18.17

Other information regarding options outstanding and exercisable at March 31, 2012 is as follows:

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

Range of exercise price	# of shares	Options Outstanding			Options Exercisable		
		Wted. Avg. Remaining	Aggregate Intrinsic	Contractual Value	# of shares	Wted. Avg. Remaining	Aggregate Intrinsic
		WAEP	Life (yrs)	(in thousands)		WAEP	(in thousands)
2.54 - \$6.00	41,350	\$ 5.16	3.14	\$ 9	37,350	\$ 5.44	\$ -
6.01 - 10.00	33,680	9.20	4.34	-	31,880	9.37	-
10.01 - 17.50	2,300	17.43	1.92	-	2,300	17.43	-
17.51 - 20.00	51,300	17.79	4.75	-	51,200	17.79	-
20.01 - 25.93	165,750	25.15	3.58	-	165,750	25.15	-
	294,380	19.18		\$ 9	288,480	19.49	\$ -

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.

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:

March
31,
2012

Dollars in thousands	
Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 46,638
Construction loans	13,311
Other loans	31,328
Standby letters of credit	1,669
Total	\$ 92,946

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.

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

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 March 31, 2012, 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.

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 March 31, 2012						
Total Capital (to risk weighted assets)						
Summit	\$ 137,469	13.3 %	\$ 82,725	8.0 %	\$ 103,407	10.0 %
Summit Community	144,207	14.0 %	82,573	8.0 %	103,216	10.0 %
Tier I Capital (to risk weighted assets)						
Summit	111,566	10.8 %	41,363	4.0 %	62,044	6.0 %
Summit Community	131,104	12.7 %	41,286	4.0 %	61,930	6.0 %
Tier I Capital (to average assets)						
Summit	111,566	7.8 %	57,393	4.0 %	71,741	5.0 %
Summit Community	131,104	9.2 %	57,313	4.0 %	71,642	5.0 %
As of December 31, 2011						

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Total Capital (to risk weighted assets)									
Summit	136,060	13.0	%	83,617	8.0	%	104,522	10.0	%
Summit Community	142,329	13.6	%	83,604	8.0	%	104,505	10.0	%
Tier I Capital (to risk weighted assets)									
Summit	109,989	10.5	%	41,809	4.0	%	62,713	6.0	%
Summit Community	129,058	12.3	%	41,802	4.0	%	62,703	6.0	%
Tier I Capital (to average assets)									
Summit	109,989	7.6	%	58,031	4.0	%	72,538	5.0	%
Summit Community	129,058	8.9	%	57,995	4.0	%	72,493	5.0	%

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

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, 2011.

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 by the parent, including overall direction in the areas of strategic planning, investment portfolio management, asset/liability management, financial reporting and other financial and administrative services. Information for each of our segments is included below:

In thousands	Three Months Ended March 31, 2012				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 10,467	\$ -	\$ (449)	\$ -	\$ 10,018
Provision for loan losses	2,001	-	-	-	2,001
Net interest income after provision for loan losses	8,466	-	(449)	-	8,017
Other income	528	1,175	261	(261)	1,703
Other expenses	6,361	1,004	435	(261)	7,539
Income (loss) before income taxes	2,633	171	(623)	-	2,181
Income tax expense (benefit)	625	69	(211)	-	483
Net income (loss)	2,008	102	(412)	-	1,698
Dividends on preferred shares	-	-	194	-	194
Net income (loss) applicable to common shares	\$ 2,008	\$ 102	\$ (606)	\$ -	\$ 1,504
Intersegment revenue (expense)	\$ (236)	\$ (25)	\$ 261	\$ -	\$ -
Average assets	\$ 1,500,416	\$ 6,367	\$ 152,954	\$ (217,225)	\$ 1,442,512

In thousands	Three Months Ended March 31, 2011				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 10,553	\$ -	\$ (451)	\$ -	\$ 10,102
Provision for loan losses	3,000	-	-	-	3,000

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Net interest income after provision for loan losses	7,553	-	(451)	-	7,102
Other income	(2,960)	1,237	1,359	(248)	(612)
Other expenses	5,738	1,027	459	(248)	6,976
Income (loss) before income taxes	(1,145)	210	449	-	(486)
Income tax expense (benefit)	(547)	90	219	-	(238)
Net income (loss)	(598)	120	230	-	(248)
Dividends on preferred shares	-	-	74	-	74
Net income (loss) applicable to common shares	\$ (598)	\$ 120	\$ 156	\$ -	\$ (322)
Intersegment revenue (expense)	\$ (219)	\$ (29)	\$ 248	\$ -	\$ -
Average assets	\$ 1,535,822	\$ 6,680	\$ 140,288	\$ (210,555)	\$ 1,472,235

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 2011 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 2.80% for the first three months in 2012 compared to the same period of 2011 while our net interest earnings on a tax equivalent basis increased 0.61%. Our tax equivalent net interest margin increased 9 basis points. Historically high levels of nonaccrual loans continue to negatively impact our net interest earnings while our reduced cost of interest bearing funds continues to positively impact our net interest earnings.

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:

Dollars in thousands	Three Months Ended March 31,	
	2012	2011
Community banking	\$ 2,007	\$ (598)
Insurance	102	120
Parent and other	(605)	156
Consolidated net income (loss)	\$ 1,504	\$ (322)

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 2011 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 2011 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 2011 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 2011 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, 2011 (date of our most recent goodwill impairment test) were as follows:

(in thousands)	Community Banking	Insurance Services
Fair value	\$ 164,235	\$ 6,929
Carrying amount	132,845	6,414
Allocated goodwill	1,488	4,710

Neither of our reporting units failed Step 1 of the goodwill impairment tests conducted as of September 30, 2011. 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:

42

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

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 balance 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.

Insurance Services – We performed an internal valuation, which was verified by a third party firm, 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 2.5%, and a discount rate of 11% 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 March 31, 2012, we had net deferred tax assets of \$12.0 million. Based on our ability to offset the net deferred tax asset against taxable income in carryback years and expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at March 31, 2012. 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.

RESULTS OF OPERATIONS

Earnings Summary

Net income applicable to common shares for the three months ended March 31, 2012 increased to \$1,504,000, or \$0.18 per diluted share as compared to a net loss of \$322,000 or \$0.04 per diluted share for the same period of 2011. Earnings were negatively impacted for all periods by continued high provisions for loan losses due to our continued increased nonperforming loans, write-downs of foreclosed properties to their estimated fair values,

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

and other-than-temporary impairment of securities. The provision for loan losses was \$2.0 million and \$3.0 million for the three months ended March 31, 2012 and 2011, respectively. Included in earnings for the three months ended March 31, 2012 was \$1.2 million of realized securities gains, \$1.9 million of charges resulting from the write down of a portion of our foreclosed properties to fair value and \$229,000 in other than temporary impairment charges on securities. Returns on average equity and assets for the first three months of 2012 were 7.13% and 0.47%, respectively, compared with (1.14%) and (0.07%) for the same period of 2011.

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 \$10,430,000 for the three months ended March 31, 2012 compared to \$10,367,000 for the same period of 2011, representing an increase of \$63,000 or 0.61%. While our earnings on interest earning assets decreased, this decrease was more than offset by a reduction in the volume of interest bearing liabilities and a reduction in the cost of interest bearing liabilities (see Table II). Average interest earning assets decreased 2.80% from \$1,350,338,000 during the first three months of 2011 to \$1,312,524,000 for the first three months of 2012. Average interest bearing liabilities declined 4.03% from \$1,294,179,000 at March 31, 2011 to \$1,242,036,000 at March 31, 2012, at an average yield for the first three months of 2012 of 2.20% compared to 2.54% for the same period of 2011.

Our consolidated net interest margin increased to 3.20% for the three months ended March 31 2012, compared to 3.11% for the same period in 2011. 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 three months ended March 31, 2012 compared to March 31, 2011, the yields on earning assets decreased 28 basis points, while the cost of our interest bearing funds decreased by 34 basis points.

Assuming no significant change in market interest rates, we anticipate a relatively stable net interest margin in the near term as 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 Three Months Ended					
	March 31, 2012			March 31, 2011		
	Average Balance	Earnings/ Expense	Yield/ Rate	Average Balance	Earnings/ Expense	Yield/ Rate
Interest earning assets						
Loans, net of unearned income (1)						
Taxable	\$973,862	\$14,279	5.90%	\$1,001,347	\$15,083	6.11%
Tax-exempt (2)	7,248	130	7.21%	4,940	98	8.05%
Securities						
Taxable	234,973	1,697	2.90%	269,858	2,609	3.92%
Tax-exempt (2)	71,559	1,092	6.14%	37,827	658	7.05%
Federal funds sold and interest bearing deposits with other banks						
Total interest earning assets	1,312,524	17,209	5.27%	1,350,338	18,465	5.55%
Noninterest earning assets						
Cash & due from banks	4,073			4,036		
Premises and equipment	21,978			22,977		
Other assets	122,188			113,000		
Allowance for loan losses	(18,251)			(18,116)		
Total assets	\$1,442,512			\$1,472,235		
Interest bearing liabilities						
Interest bearing demand deposits						
Savings deposits	\$160,147	\$82	0.21%	\$148,263	\$100	0.27%
Time deposits	211,783	381	0.72%	197,638	501	1.03%
Short-term borrowings	550,689	3,250	2.37%	623,318	4,142	2.69%
Long-term borrowings and capital trust securities	14,390	7	0.20%	1,734	1	0.23%
Total liabilities	305,027	3,059	4.03%	323,226	3,354	4.21%
Total interest bearing liabilities	1,242,036	6,779	2.20%	1,294,179	8,098	2.54%

Total interest bearing liabilities			
Noninterest bearing liabilities and shareholders' equity			
Demand deposits	87,000		78,023
Other liabilities	8,850		9,634
Total liabilities	1,337,886		1,381,836
Shareholders' equity - preferred	9,326		3,519
Shareholders' equity - common	95,300		86,880
Total liabilities and shareholders' equity	\$1,442,512		\$1,472,235
Net interest earnings		\$10,430	\$10,367
Net yield on interest earning assets		3.20%	3.11%

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

(2) - Interest income on tax-exempt securities and loans 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 \$412,000 and \$265,000 for the periods ended

March 31, 2012 and March 31 2011, 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		
	March 31, 2012 versus March 31, 2011		
	Increase (Decrease) Due to Change in:		
	Volume	Rate	Net
Interest earned on:			
Loans			
Taxable	\$ (355)	\$ (449)	\$ (804)
Tax-exempt	43	(11)	32
Securities			
Taxable	(303)	(609)	(912)
Tax-exempt	528	(94)	434
Federal funds sold and interest			
bearing deposits with other banks	(5)	(1)	(6)
Total interest earned on interest earning assets	(92)	(1,164)	(1,256)
Interest paid on:			
Interest bearing demand			
deposits	8	(26)	(18)
Savings deposits	35	(155)	(120)
Time deposits	(441)	(451)	(892)
Short-term borrowings	6	-	6
Long-term borrowings and capital			
trust securities	(170)	(125)	(295)
Total interest paid on interest bearing liabilities	(562)	(757)	(1,319)
Net interest income	\$ 470	\$ (407)	\$ 63

Noninterest Income

Total noninterest income increased to \$1,703,000 for the first three months of 2012, compared to a loss of \$482,000 for the same period of 2011, with other-than-temporary impairment charges on securities and writedowns of foreclosed properties to their estimated fair value being the primary negative components. Further detail regarding noninterest income is reflected in the following table.

Table III - Noninterest
Income

Dollars in thousands	For the Quarter Ended	
	March 31,	
	2012	2011
Insurance commissions	\$ 1,158	\$ 1,242
Service fees	1,014	888
Realized securities gains (losses)	1,165	1,628
Other-than-temporary impairment of securities	(229)	(1,228)
Gain (loss) on sale of assets	(77)	71
Bank owned life insurance income	275	130
Writedown of foreclosed properties	(1,912)	(3,443)
Other	309	230
Total	\$ 1,703	\$ (482)

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 three months of 2012, we recorded non-cash other-than temporary impairment charges of \$229,000 related to certain residential mortgage-backed securities which we continue to own.

Writedown of foreclosed properties: During the first three months of 2012, we recorded \$1,912,000 in charges to writedown certain OREO properties to fair value less estimated costs to sell as part of our normal, ongoing re-appraisal process. Continued volatility in the real estate markets could result in further writedowns of these properties in the foreseeable future.

Noninterest Expense

Total noninterest expense increased approximately 6.1% for the three months ended March 31, 2012, as compared to the same period in 2011. While professional fees, primarily related to complex collection issues relative to our problem assets, continue to increase, FDIC premiums are lower in 2012 due to our lower deposit base and a change in the assessment base used in calculating FDIC premiums that became effective during second quarter 2011. Other expenses are higher in 2012 due to the refund during first quarter 2011 of Virginia business franchise taxes paid or accrued for due to an allowable credit for property taxes paid on foreclosed properties in Virginia being an allowable offset to taxable capital for business franchise tax calculation purposes. Table IV below shows the breakdown of the changes.

Table IV - Noninterest
Expense

Dollars in thousands	For the Quarter Ended March 31,				2011
	2012	\$	%	Change	
Salaries, commissions, and employee benefits	\$ 3,901	\$ (71)	-1.8 %		\$ 3,972
Net occupancy expense	479	(30)	-5.9 %		509
Equipment expense	594	14	2.4 %		580
Professional fees	304	108	55.1 %		196
Amortization of intangibles	88	-	0.0 %		88
FDIC premiums	522	(171)	-24.7 %		693
OREO expense	374	(60)	-13.8 %		434
Other	1,277	643	101.4 %		634
Total	\$ 7,539	\$ 433	6.1 %		\$ 7,106

Credit Experience

Due to continued recessionary economic conditions, borrowers have in many cases been unable to refinance their loans 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 with regard to our construction &

development , residential real estate, and commercial real estate loan portfolios. It is not known when the housing market will stabilize. Management anticipates loan delinquencies will remain higher than historical levels in 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.

We recorded \$2,001,000 and \$3,000,000 provisions for loan losses for the first three months of 2012 and 2011, respectively. This decline is a result of lower levels of specific reserves, based upon the fair value of collateral method in measuring impairment, necessary on newly identified impaired loans at March 31, 2012 compared to March 31, 2011.

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

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

Table V - Summary
of Non-Performing
Assets

Dollars in thousands	2012	March 31, 2011	December 31, 2011
Accruing loans past due 90 days or more	\$ -	\$ 9	\$ 344
Nonaccrual loans			
Commercial	2,477	2,186	3,260
Commercial real estate	4,282	5,284	7,163
Commercial construction and development	799	131	1,052
Residential construction and development	21,375	8,428	22,289
Residential real estate	17,754	6,343	18,187
Consumer	81	197	145
Total nonaccrual loans	46,768	22,569	52,096
Foreclosed properties			
Commercial	-	597	-
Commercial real estate	14,703	13,738	15,721
Commercial construction and development	17,377	16,918	17,101
Residential construction and development	25,724	32,002	27,877
Residential real estate	3,780	3,706	3,239
Consumer	-	-	-
Total foreclosed properties	61,584	66,961	63,938
Repossessed assets	266	262	263
Total nonperforming assets	\$ 108,618	\$ 89,801	\$ 116,641

Total nonperforming loans as a percentage of total loans	4.79	%	2.26	%	5.33	%
Total nonperforming assets as a percentage of total assets	7.52	%	6.06	%	8.04	%

The following table details the activity regarding our foreclosed properties for the three months ended March 31, 2012 and 2011.

Table VI - Foreclosed Property Activity	For the Three Months Ended March 31,	
	2012	2011
Dollars in thousands		
Balance January 1	\$ 63,938	\$ 70,235
Acquisitions	1,084	1,707
Improvements	212	126
Disposals	(1,319)	(1,664)
Writedowns to fair value	(1,912)	(3,443)
Reclassification of covered loans	(419)	-
Balance March 31	\$ 61,584	\$ 66,961

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 March 31, 2012.

Table VII - Significant Nonperforming Loan Relationships

March 31,
2012

Dollars in
thousands

Location	Underlying Collateral	Loan Origination Date	Loan Nonaccrual Date	Loan Balance	Method Used to Measure Impairment	Most Recent Appraised Value	Amount Allocated to Allowance for Loan Losses	Amount Previously Charged-off
Hardy Co., WV	Residential subdivision & residential building lots	Apr. 2008	Dec. 2011	\$ 1,232	Collateral value	\$ 1,827 (1)	\$ -	\$ -
Rockingham Co., VA	Residential subdivision	Jun. 2009	Nov. 2011	\$ 1,600	Collateral value	\$ 1,668 (1)	\$ 99	\$ 714
Shenandoah Co., VA	Residential subdivision & residential building lot	Sept. 2005 & Feb. 2009	Dec. 2011	\$ 1,845	Collateral value	\$ 1,316 (1)	\$ 765	\$ -
Shenandoah Co., VA	Residential Building Lots & One Commercial Lot	Feb. 2008	Jan. 2012	\$ 1,539	Collateral value	\$ 1,200 (1)	\$ 459	\$ -
Shenandoah Co., & Frederick Co., VA	Residential Building Lots	Aug. 2004, July 2005, & July 2007	Jun. 2011	\$ 2,116	Collateral value	\$ 2,020 (1)	\$ 381	\$ -
Faquier Co., VA	Single family residence & Business Investment	Aug. 2007, Oct. 2007 & Sept. 2008	Dec. 2011	\$ 12,621	Collateral value	\$ 16,714(1)	\$ 414	\$ -
Howard County, MD	7 Single family residences	Aug., Sept., Oct. & Dec. 2008 & Feb. 2009	Feb. 2012	\$ 1,118	Collateral value	\$ 843 (3)	\$ 388	\$ -
Jefferson Co., WV	Residential development	Mar. 2008 & June 2008	Jun. 2011	\$ 8,378	Collateral value	\$ 9,666 (1)	\$ 771	\$ -

	& undeveloped acreage								
Rockingham Co., VA	Residential Subdivision & 2 single family residential building lots	Jun. 2008	Sept. 2011	\$ 2,137	Collateral value	\$ 1,792	(1)	\$ 504	\$ -
Kanawha Co., WV	UCC Business Assets & Residential Subdivision	Feb. 2003, Mar. 2008 & Apr. 2008	May 2011 & Jul. 2011	\$ 1,246	Collateral value	\$ 1,653	(2)	\$ 31	\$ -

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

(2) - Value is based upon current appraisal on the real estate and most recent estimate on business assets.

(3) - Value is based upon 2012 tax assessments.

Refer to Note 6 of the accompanying consolidated financial statements for information regarding our past due loans, impaired loans, nonaccrual loans, and troubled debt restructurings.

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:

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

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. 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.

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 all loan segments detailed above an allocation equaling 100% of the respective pool's average 12 month historical net loan charge-off rate (determined based upon the most recent twelve quarters) is applied to the aggregate recorded investment in the 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.

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

Commercial-related loans (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination includes 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.

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 in many of our nonperforming loans, and therefore, no specific reserve allocation is required; as of March 31, 2012, approximately 64% of our impaired loans required no reserves or have been charged down to their fair value. Accordingly, our allowance for loan losses has not increased proportionately as our nonperforming loans have increased. 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 rate applied to the loans which are collectively evaluated for impairment.

At March 31, 2012, December 31, 2011, and March 31, 2011, our allowance for loan losses totaled \$18,523,000, or 1.89% of total loans, \$17,712,000, or 1.80% of total loans and \$16,933,000, or 1.70% of total loans, respectively, and is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio.

At March 31, 2012, December 31, 2011, and March 31, 2011, we had approximately \$61,584,000, \$63,938,000 and \$66,961,000, 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 \$1,444,365,000 at March 31, 2012, compared to \$1,450,121,000 at December 31, 2011, representing a 0.40% decrease. Table VIII below serves to illustrate significant changes in our financial position between December 31, 2011 and March 31, 2012.

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

Table VIII - Summary of Significant Changes in Financial Position

Dollars in thousands	Balance December 31, 2011	Increase (Decrease)		Balance March 31, 2012
		Amount	Percentage	
Assets				
Securities available for sale	\$ 286,599	5,403	1.9 %	\$ 292,002
Loans, net of unearned interest	983,228	(6,908)	-0.7 %	976,320
Liabilities				
Deposits	\$ 1,016,500	\$ (5,361)	-0.5 %	\$ 1,011,139
Short-term borrowings	15,956	-	0.0 %	15,956
Long-term borrowings	270,254	(3,133)	-1.2 %	267,121
Subordinated debentures	16,800	-	0.0 %	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	-	0.0 %	19,589

Loans decreased slightly and securities increased 1.9% during the first three months of 2012. We have slowed our loan growth due to the current weakened economic conditions in our market areas and limited availability of new capital resources.

Deposits decreased approximately \$5.4 million during the first three months of 2012; wholesale deposits decreased approximately \$6.6 million while retail deposits increased approximately \$1.2 million.

The decrease in long term borrowings is primarily attributable to maturities and repayments of long-term FHLB advances during the first three months of 2012.

Refer to Notes 5, 6, 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 March 31, 2012 and December 31, 2011.

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”) and Federal Reserve Bank of Richmond, which totaled approximately \$378.4 million or 26.2% of total consolidated assets at March 31, 2012.

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 \$310 million. As of March 31, 2012 and December 31, 2011, these advances totaled approximately \$173 million and \$175 million, respectively. At March 31, 2012, we had additional borrowing capacity of \$138 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 March 31, 2012 was approximately \$101 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.

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

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 \$378 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 \$5.5 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.

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, and
- Would still have available current liquid funding sources secured by unencumbered loans and securities totaling \$273 million aside from its FHLB line, which would result in a funding source of approximately \$226 million.

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 \$378 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.

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

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 March 31, 2012 totaled \$104,399,000 compared to \$102,566,000 at December 31, 2011.

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 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.

Dividends on Summit's preferred stock, as well as interest payments on our subordinated debt and junior subordinated debentures underlying our trust preferred securities, continue to be permissible. However, such dividends and interest payments on our preferred stock and trust preferred debt are subject to future review by the regulatory authorities should we continue to experience deterioration in our financial condition.

Although dividends from Summit Community are the principal source of funds to pay dividends, interest, and principal payments on Summit's preferred stock, subordinated debentures (including those owed to unconsolidated subsidiary trusts), and term bank borrowing, we currently have sufficient cash on hand to continue to service our subordinated debentures and term bank borrowing obligations as well as the dividend payments on our preferred stock through at least 2013. Nevertheless, we can make no assurances that we will continue to have sufficient funds available for Summit's debt service and for distributions to the holders of our preferred stock.

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 March 31, 2012.

54

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

Table IX -
 Contractual Cash
 Obligations

	Long Term Debt	Capital Trust Securities	Operating Leases
Dollars in thousands			
2012	\$ 64,304	\$ -	\$ 183
2013	41,898	-	235
2014	83,429	-	175
2015	11,909	-	21
2016	1,911	-	-
Thereafter	80,470	19,589	-
Total	\$ 283,921	\$ 19,589	\$ 614

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 March 31, 2012 are presented in the following table.

Table X -
 Off-Balance Sheet
 Arrangements

	March 31, 2012
Dollars in thousands	
Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 46,638
Construction loans	13,311
Other loans	31,328
Standby letters of credit	1,669
Total	\$ 92,946

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 March 31, 2012. 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.

Change in Interest Rates (basis points)	Estimated % Change in Net Interest Income Over:	
	0-12 Months	13-24 Months

Down 100 (1)	1.37 %	4.52 %
Up 100 (1)	-2.14 %	-0.95 %
Up 200 (1)	-4.35 %	-2.82 %
Up 400 (2)	-4.35 %	-4.11 %

(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 March 31, 2012, 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 March 31, 2012 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2012 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, 2011.

Item 6. Exhibits

- Exhibit 3.i Amended and Restated Articles of Incorporation of Summit Financial Group, Inc.
- Exhibit 3.ii Articles of Amendment 2009
- Exhibit 3.iii Articles of Amendment 2011
- Exhibit 3.iv Amended and Restated By-Laws of Summit Financial Group, Inc.
- 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
- Exhibit 101 Interactive Data File (XBRL)

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: May 3, 2012

EXHIBIT INDEX

Exhibit No.	Description	Page Number
(3)	Articles of Incorporation and By-laws:	
	(i) Amended and Restated Articles of Incorporation of (a) Summit Financial Group, Inc.	
	(ii) Articles of Amendment 2009	(b)
	(iii) Articles of Amendment 2011	(c)
	(iv) Amended and Restated By-laws of Summit Financial Group, Inc.	(d)
11	Statement re: Computation of Earnings per Share	15
31.1	Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer	
31.2	Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer	
32.1*	Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer	
32.2*	Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer	
101**	Interactive data file (XBRL)	

* Furnished, not filed.

** As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

- (a) Incorporated by reference to Exhibit 3.i of Summit Financial Group, Inc.'s filing on Form 10-Q dated March 31, 2006.
- (b) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated September 30, 2009.
- (c) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated November 3, 2011.
- (d) Incorporated by reference to Exhibit 3.2 of Summit Financial Group, Inc.'s filing on Form 10-Q dated June 30, 2006.

