SUMMIT FINANCIAL GROUP INC
Form 10-Q
November 03, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10 – Q

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

For the quarterly period ended September 30, 2016
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	55-0672148
(State or other jurisdiction of incorporation or organization)	(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 þ No o

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 þ No o

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 o	Accelerated filer þ
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

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
10,704,441 shares outstanding as of November 1, 2016

Table of Contents

Table of Contents

Consolidated Balance Sheets (unaudited)

Dollars in thousands	September 30, 2016 (unaudited)	December 31, 2015 (*)	September 30, 2015 (unaudited)
ASSETS			
Cash and due from banks	$ 25,067	$ 3,625	$ 4,232
Interest bearing deposits with other banks	9,432	5,862	8,057
Cash and cash equivalents	34,499	9,487	12,289
Securities available for sale	262,102	280,792	272,127
Other investments	13,182	8,949	7,016
Loans held for sale, net	—	779	83
Loans, net	1,234,605	1,079,331	1,062,348
Property held for sale	24,767	25,567	29,713
Premises and equipment, net	21,802	21,572	20,457
Accrued interest receivable	5,470	5,544	5,295
Intangible assets	7,348	7,498	7,548
Cash surrender value of life insurance policies	38,504	37,732	37,481
Other assets	15,357	15,178	14,947
Total assets	$ 1,657,636	$ 1,492,429	$ 1,469,304
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	$ 122,652	$ 119,010	$ 118,887
Interest bearing	1,034,132	947,699	953,204
Total deposits	1,156,784	1,066,709	1,072,091
Short-term borrowings	234,657	171,394	145,291
Long-term borrowings	74,146	75,581	76,059
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	18,640	15,412	15,985
Total liabilities	1,503,816	1,348,685	1,329,015
Commitments and Contingencies			
Shareholders' Equity			
Preferred stock, $1.00 par value, authorized 250,000 shares	—	—	—
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares; issued: 10,857,801 shares 2016, 10,853,566 shares December 2015 and 10,844,912 shares September 2015; outstanding: 10,701,841 shares 2016, 10,671,744 shares December 2015 and 10,658,199 shares September 2015	46,114	45,741	45,612
Unallocated common stock held by Employee Stock Ownership Plan - 2016 - 155,960 shares, December 2015 - 181,822 shares and September 2015 - 186,713 shares	(1,684)	(1,964)	(2,017)
Retained earnings	109,808	100,423	97,129
Accumulated other comprehensive income	(418)	(456)	(435)

Total shareholders' equity	153,820	143,744	140,289
Total liabilities and shareholders' equity	$ 1,657,636	$ 1,492,429	$ 1,469,304

(*) - December 31, 2015 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statements of Income (unaudited)

Dollars in thousands, except per share amounts	For the Three Months Ended September 30, 2016	2015	For the Nine Months Ended September 30, 2016	2015
Interest income				
Interest and fees on loans				
Taxable	$14,009	$12,855	$40,788	$38,443
Tax-exempt	133	128	412	361
Interest and dividends on securities				
Taxable	1,138	933	3,284	3,302
Tax-exempt	621	610	1,857	1,821
Interest on interest bearing deposits with other banks	5	5	13	6
Total interest income	15,906	14,531	46,354	43,933
Interest expense				
Interest on deposits	2,209	2,106	6,533	6,251
Interest on short-term borrowings	675	130	1,334	369
Interest on long-term borrowings and subordinated debentures	985	990	2,937	3,030
Total interest expense	3,869	3,226	10,804	9,650
Net interest income	12,037	11,305	35,550	34,283
Provision for loan losses	—	250	500	1,000
Net interest income after provision for loan losses	12,037	11,055	35,050	33,283
Other income				
Insurance commissions	1,016	983	3,030	3,191
Service fees related to deposit accounts	1,138	1,111	3,175	3,159
Realized securities gains	61	373	836	1,023
Bank owned life insurance income	258	259	772	782
Other	276	267	788	837
Total other income	2,749	2,993	8,601	8,992
Other expense				
Salaries, commissions, and employee benefits	4,819	4,479	14,265	13,108
Net occupancy expense	525	496	1,576	1,483
Equipment expense	716	582	2,059	1,677
Professional fees	270	402	1,171	1,109
Amortization of intangibles	50	50	150	150
FDIC premiums	200	300	800	950
Merger expense	80	—	345	—
Foreclosed properties expense	100	168	317	534
(Gain) loss on sales of foreclosed properties	(169)	35	(451)	288
Write-downs of foreclosed properties	134	1,046	503	1,779
Other	1,694	1,314	4,675	4,060
Total other expense	8,419	8,872	25,410	25,138
Income before income taxes	6,367	5,176	18,241	17,137
Income tax expense	2,086	1,515	5,655	5,181
Net Income	$4,281	$3,661	$12,586	$11,956
Basic earnings per common share	$0.40	$0.34	$1.18	$1.19
Diluted earnings per common share	$0.40	$0.34	$1.18	$1.12

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statement of Comprehensive Income (unaudited)

Dollars in thousands	For the Three Months Ended September 30, 2016	2015
Net income	$4,281	$3,661
Other comprehensive income (loss):		
Net unrealized gain (loss) on cashflow hedge of: 2016 - $965, net of deferred taxes of $357; 2015 - ($2,033), net of deferred taxes of ($752)	608	(1,281)
Net unrealized gain (loss) on available for sale debt securities of: 2016 - ($1,437), net of deferred taxes of ($532) and reclassification adjustment for net realized gains included in net income of $61; 2015 - $1,041, net of deferred taxes of $385 and reclassification adjustment for net realized gains included in net income of $373	(905)	656
Total comprehensive income	$3,984	$3,036

Dollars in thousands	For the Nine Months Ended September 30, 2016	2015
Net income	$12,586	$11,956
Other comprehensive income (loss):		
Net unrealized loss on cashflow hedge of: 2016 - ($2,114), net of deferred taxes of ($782); 2015 - ($3,063), net of deferred taxes of ($1,133)	(1,332)	(1,930)
Net unrealized gain (loss) on available for sale debt securities of: 2016 - $2,175, net of deferred taxes of $805 and reclassification adjustment for net realized gains included in net income of $836; 2015 - ($916), net of deferred taxes of ($339) and reclassification adjustment for net realized gains included in net income of $1,023	1,370	(577)
Total comprehensive income	$12,624	$9,449

See Notes to Consolidated Financial Statements

Table of Contents

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	Unallocated Common Stock Held by ESOP	Retained Earnings	Accumulated Other Compre-hensive Income	Total Share-holders' Equity
Balance, December 31, 2015	$—	$—	$45,741	$ (1,964)	$100,423	$ (456)	$143,744
Nine Months Ended September 30, 2016							
Comprehensive income:							
Net income	—	—	—	—	12,586	—	12,586
Other comprehensive income	—	—	—	—	—	38	38
Total comprehensive income							12,624
Stock compensation expense	—	—	150	—	—	—	150
Unallocated ESOP shares committed to be released - 25,862 shares	—	—	148	280	—	—	428
Common stock issuances from reinvested dividends	—	—	75	—	(75)	—	—
Common stock cash dividends declared ($0.30 per share)	—	—	—	—	(3,126)	—	(3,126)
Balance, September 30, 2016	$—	$—	$46,114	$ (1,684)	$109,808	$ (418)	$153,820
Balance, December 31, 2014	$3,419	$5,764	$32,670	$—	$87,719	$ 2,072	$131,644
Nine Months Ended September 30, 2015							
Comprehensive income:							
Net income	—	—	—	—	11,956	—	11,956
Other comprehensive loss	—	—	—	—	—	(2,507)	(2,507)
Total comprehensive income							9,449
Stock compensation expense	—	—	100	—	—	—	100
Conversion of Series 2009 Preferred Stock to common stock	(3,419)	—	3,404	—	—	—	(15)
Conversion of Series 2011 Preferred Stock to common stock	—	(5,764)	5,748	—	—	—	(16)
Issuance of 497,571 shares of common stock	—	—	4,747	—	—	—	4,747
Purchase of unallocated common stock of 208,333 held by ESOP	—	—	—	(2,250)	—	—	(2,250)
Unallocated ESOP shares committed to be released - 21,620 shares	—	—	23	233	—	—	256
Repurchase and retirement of 100,000 shares of common stock	—	—	(1,080)	—	—	—	(1,080)
	—	—	—	—	(2,546)	—	(2,546)

Common stock cash dividends declared ($0.24 per share)							
Balance, September 30, 2015	$—	$—	$45,612	$ (2,017)	$97,129	$ (435)	$140,289

See Notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows (unaudited)

Dollars in thousands	Nine Months Ended September 30, 2016	September 30, 2015
Cash Flows from Operating Activities		
Net income	$12,586	$ 11,956
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	884	790
Provision for loan losses	500	1,000
Stock compensation expense	150	101
Deferred income tax expense (benefit)	(235)	97
Loans originated for sale	(7,068)	(2,997)
Proceeds from loans sold	7,847	3,441
Securities gains	(836)	(1,023)
(Gain) loss on disposal of assets	(480)	290
Write-downs of foreclosed properties	503	1,779
Amortization of securities premiums (accretion of discounts), net	3,338	3,952
Amortization of intangibles, net	150	159
Decrease in accrued interest receivable	75	543
Increase in cash surrender value of bank owned life insurance	(772)	(781)
Increase in other assets	(762)	(564)
Increase in other liabilities	673	239
Net cash provided by operating activities	16,553	18,982
Cash Flows from Investing Activities		
Proceeds from maturities and calls of securities available for sale	630	1,743
Proceeds from sales of securities available for sale	63,641	54,080
Principal payments received on securities available for sale	27,696	30,884
Purchases of securities available for sale	(73,595)	(79,844)
Purchases of other investments	(15,389)	(6,528)
Proceeds from sales & redemptions of other investments	10,942	5,695
Net loans made to customers	(156,744)	(45,882)
Purchases of premises and equipment	(1,199)	(1,187)
Proceeds from disposal of premises and equipment	43	—
Proceeds from sales of other repossessed assets & property held for sale	3,659	8,984
Net cash (used in) investing activities	(140,316)	(32,055)
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and savings accounts	54,831	22,248
Net increase (decrease) in time deposits	35,244	(11,502)
Net increase in short-term borrowings	63,263	21,658
Repayment of long-term borrowings	(1,435)	(1,431)
Repayment of subordinated debt	—	(16,800)
Net proceeds from issuance of common stock	—	4,704
Retirement of common stock	—	(1,080)
Purchase of unallocated common stock held by ESOP	—	(2,250)
Dividends paid on common stock	(3,128)	(2,504)
Dividends paid on preferred stock	—	(191)
Net cash provided by financing activities	148,775	12,852
Increase (decrease) in cash and cash equivalents	25,012	(221)

Cash and cash equivalents:		
Beginning	9,487	12,510
Ending	$34,499	$ 12,289

(Continued)

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statements of Cash Flows (unaudited) - continued

Dollars in thousands	Nine Months Ended September 30, 2016	September 30, 2015
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$10,889	$ 9,693
Income taxes	$5,768	$ 5,345
Supplemental Schedule of Noncash Investing and Financing Activities		
Real property and other assets acquired in settlement of loans	$2,053	$ 2,404

See Notes to Consolidated Financial Statements

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 and nine months ended September 30, 2016 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 2015 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2015 and September 30, 2015, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) - Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 was effective for us January 1, 2016, and did not have a significant impact on our financial statements.

ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs specifies that debt issuance costs related to a recognized liability are to be reported in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. ASU 2015-03 was effective for us January 1, 2016 and did not have a material impact on our financial statements.

The guidance of ASU No. 2015-03 did not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance for debt issuance costs related to line-of-credit arrangements within the update, in ASU 2015-15, Interest—Imputation of Interest (Subtopic 835-30) - Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting), issued in August 2015, the SEC staff stated that they would not object to any entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement.

ASU 2015-16, Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments requires that adjustments to provisional amounts that are identified during the measurement period of a business combination be recognized in the reporting period in which the adjustment amounts are determined. Furthermore, the income statement effects of such adjustments, if any, must be calculated as if the accounting had been completed at the acquisition date reflecting the portion of the amount recorded in current-period earnings that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. Under previous guidance, adjustments to provisional amounts identified during the measurement period are to be recognized retrospectively. ASU 2015-16 became effective for us on January 1, 2016 and did not have a significant impact on our financial statements.

ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to

Table of Contents

be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2016-02, Leases (Topic 842) will, among other things, require lessees to recognize a lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, Revenue from Contracts with Customers. ASU 2016-02 will be effective for us on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the potential impact of ASU 2016-02 on our financial statements.

ASU 2016-05, Derivatives and Hedging (Topic 815) Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships, clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under ASC Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria continue to be met. ASU 2016-05 will be effective for us on January 1, 2017 and is not expected to have a significant impact on our financial statements.

ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, requires that all excess tax benefits and tax deficiencies related to share-based payment awards be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 will be effective on January 1, 2017 and is not expected to have a significant impact on our financial statements.

ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective on January 1, 2020. We are currently evaluating the potential impact of ASU 2016-13 on our financial statements.

ASU 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. ASU 2016-15 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2016 16, Intra-Entity Transfers of Assets Other Than Inventory requires an entity to recognize the income tax consequences of intra-entity transfers of assets other than inventory at the time that the transfer occurs. Current guidance does not require recognition of tax consequences until the asset is eventually sold to a third party. ASU 2016-16 is effective for fiscal years, and interim periods within, beginning after December 15, 2017, with early adoption permitted as of the first interim period presented in a year. We are evaluating the impact of the adoption of ASU 2016 16 on January 1, 2018 to our consolidated 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.

Derivative Financial Instruments: Derivative financial instruments are recorded at fair value on a recurring basis. Fair value measurement is based on pricing models run by a third-party, utilizing observable market-based inputs. All future floating cash flows are projected and both floating and fixed cash flows are discounted to the valuation date. As a result, we classify interest rate swaps as Level 2.

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 loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the original 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 discounted cash flows or collateral value exceeds the recorded investments in such loans. These loans are carried at recorded loan investment, and therefore are not included in the following tables of loans measured at fair value. Impaired loans internally graded as substandard, doubtful, or loss are evaluated using the fair value of collateral method. All other impaired loans are measured for impairment using the discounted cash flows method. 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.

When impaired loans are deemed required to be included in the fair value hierarchy, 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.

Foreclosed properties: Foreclosed properties 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 foreclosed properties 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 foreclosed properties 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 expense 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 and liabilities measured at fair value on a recurring basis.

	Balance at	Fair Value Measurements Using:		
Dollars in thousands	September 30, 2016	Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$ 15,692	$—	$15,692	$—
Mortgage backed securities:				
Government sponsored agencies	135,205	—	135,205	—
Nongovernment sponsored entities	5,401	—	5,401	—
State and political subdivisions	250	—	250	—
Corporate debt securities	19,903	—	8,597	11,306
Other equity securities	77	—	77	—
Tax-exempt state and political subdivisions	85,574	—	85,574	—
Total available for sale securities	$ 262,102	$—	$250,796	$11,306
Derivative financial liabilities				
Interest rate swaps	$ 8,270	$—	$8,270	$—

Dollars in thousands	Balance at December 31, 2015	Fair Value Measurements Using: Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$ 21,475	$ —	$ 21,475	$ —
Mortgage backed securities:				
Government sponsored agencies	146,734	—	146,734	—
Nongovernment sponsored entities	7,885	—	7,885	—
State and political subdivisions	1,953	—	1,953	—
Corporate debt securities	14,226	—	8,367	5,859
Other equity securities	77	—	77	—
Tax-exempt state and political subdivisions	88,442	—	88,442	—
Total available for sale securities	$ 280,792	$ —	$ 274,933	$ 5,859
Derivative financial liabilities				
Interest rate swaps	$ 5,072	$ —	$ 5,072	$ —

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	Balance at September 30, 2016	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$ —	$ —	$ —	$ —
Collateral-dependent impaired loans				
Commercial	$ —	$ —	$ —	$ —
Commercial real estate	—	—	—	—
Construction and development	648	—	648	—
Residential real estate	130	—	130	—
Total collateral-dependent impaired loans	$ 778	$ —	$ 778	$ —
Foreclosed properties				
Commercial real estate	$ 976	$ —	$ 976	$ —
Construction and development	19,933	—	19,933	—
Residential real estate	279	—	279	—
Total foreclosed properties	$ 21,188	$ —	$ 21,188	$ —

	Balance at	Fair Value Measurements Using:

Dollars in thousands	December 31, 2015	Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$ 779	$—	$779	$—
Collateral-dependent impaired loans				
Commercial	$ —	—	$—	$—
Commercial real estate	627	—	—	627
Construction and development	1,054	—	—	1,054
Residential real estate	279	—	279	—
Total collateral-dependent impaired loans	$ 1,960	$—	$279	$1,681
Foreclosed properties				
Commercial real estate	$ 1,103	$—	$1,103	$—
Construction and development	18,477	—	18,419	58
Residential real estate	314	—	314	—
Total foreclosed properties	$ 19,894	$—	$19,836	$58

Table of Contents

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 cash equivalents: The carrying values of cash and cash equivalents 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.

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

Derivative financial instruments: The fair value of the interest rate swaps is valued using independent pricing models.

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	September 30, 2016 Carrying Value	September 30, 2016 Estimated Fair Value	December 31, 2015 Carrying Value	December 31, 2015 Estimated Fair Value
Financial assets				
Cash and cash equivalents	$34,499	$34,499	$9,487	$9,487
Securities available for sale	262,102	262,102	280,792	280,792
Other investments	13,182	13,182	8,949	8,949
Loans held for sale, net	—	—	779	779
Loans, net	1,234,605	1,251,189	1,079,331	1,084,955
Accrued interest receivable	5,470	5,470	5,544	5,544
	$1,549,858	$1,566,442	$1,384,882	$1,390,506
Financial liabilities				
Deposits	$1,156,784	$1,168,549	$1,066,709	$1,077,510
Short-term borrowings	234,657	234,657	171,394	171,394
Long-term borrowings	74,146	77,670	75,581	80,506
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589	19,589
Accrued interest payable	741	741	826	826
Derivative financial liabilities	8,270	8,270	5,072	5,072
	$1,494,187	$1,509,476	$1,339,171	$1,354,897

NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

Dollars in thousands, except per share amounts	For the Three Months Ended September 30, 2016 Income (Numerator)	2016 Common Shares (Denominator)	2016 Per Share	2015 Income (Numerator)	2015 Common Shares (Denominator)	2015 Per Share
Net income	$4,281			$3,661		
Basic EPS	$4,281	10,692,423	$0.40	$3,661	10,703,526	$0.34
Effect of dilutive securities:						
Stock options		12,865			8,677	
Stock appreciation rights		21,851			—	
Diluted EPS	$4,281	10,727,139	$0.40	$3,661	10,712,203	$0.34

Table of Contents

	For the Nine Months Ended September 30,					
	2016			2015		
Dollars in thousands, except per share amounts	Income (Numerator)	Common Shares (Denominator)	Per Share	Income (Numerator)	Common Shares (Denominator)	Per Share
Net income	$12,586			$11,956		
Basic EPS	$12,586	10,682,129	$1.18	$11,956	10,069,374	$1.19
Effect of dilutive securities:						
Stock options		8,774			8,608	
Stock appreciation rights		1,443			—	
Series 2011 convertible preferred stock	—	—		—	381,859	
Series 2009 convertible preferred stock	—	—		—	168,298	
Diluted EPS	$12,586	10,692,346	$1.18	$11,956	10,628,139	$1.12

Stock option and stock appreciation right (SAR) grants and the convertible preferred shares are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options for the quarter and nine months ended September 30, 2016 were 33,600 shares and 57,000 shares respectively, and totaled 128,900 shares for both the quarter and nine months ended September 30, 2015. Our anti-dilutive SARs for both the three and nine months ended September 30, 2015 were 166,717.

NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at September 30, 2016, December 31, 2015, and September 30, 2015 are summarized as follows:

	September 30, 2016			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	$14,818	$921	$ 47	$15,692
Residential mortgage-backed securities:				
Government-sponsored agencies	132,913	2,556	264	135,205
Nongovernment-sponsored entities	5,382	48	29	5,401
State and political subdivisions				
Water and sewer revenues	250	—	—	250
Corporate debt securities	20,003	49	149	19,903
Total taxable debt securities	173,366	3,574	489	176,451
Tax-exempt debt securities				
State and political subdivisions				
General obligations	47,014	2,221	115	49,120
Water and sewer revenues	7,980	265	11	8,234
Lease revenues	7,392	321	38	7,675
Sales tax revenues	2,880	124	—	3,004
Other revenues	16,869	701	29	17,541

Total tax-exempt debt securities	82,135	3,632	193	85,574
Equity securities	77	—	—	77
Total available for sale securities	$255,578	$7,206	$ 682	$262,102

Table of Contents

	December 31, 2015			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	$20,461	$1,063	$49	$21,475
Residential mortgage-backed securities:				
Government-sponsored agencies	145,586	1,943	795	146,734
Nongovernment-sponsored entities	7,836	82	33	7,885
State and political subdivisions				
Water and sewer revenues	250	—	—	250
Other revenues	1,729	—	26	1,703
Corporate debt securities	14,494	—	268	14,226
Total taxable debt securities	190,356	3,088	1,171	192,273
Tax-exempt debt securities				
State and political subdivisions				
General obligations	52,490	1,767	41	54,216
Water and sewer revenues	7,614	172	—	7,786
Lease revenues	8,671	187	1	8,857
Special tax revenues	4,532	72	—	4,604
Other revenues	12,703	290	14	12,979
Total tax-exempt debt securities	86,010	2,488	56	88,442
Equity securities	77	—	—	77
Total available for sale securities	$276,443	$5,576	$1,227	$280,792

	September 30, 2015			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable debt securities:				
U.S. Government and agencies and corporations	$26,816	$1,275	$ 37	$28,054
Residential mortgage-backed securities:				
Government-sponsored agencies	141,116	2,854	406	143,564
Nongovernment-sponsored agencies	8,641	96	36	8,701
State and political subdivisions:				
Water and sewer revenues	500	1	—	501
Lottery/casino revenues	1,214	—	29	1,185
Other revenues	1,733	7	—	1,740
Corporate debt securities	10,796	17	144	10,669
Total taxable debt securities	190,816	4,250	652	194,414
Tax-exempt debt securities:				
State and political subdivisions:				
General obligations	47,618	1,638	197	49,059
Water and sewer revenues	8,954	94	9	9,039
Lease revenues	3,982	34	9	4,007
Special tax revenues	4,540	46	55	4,531
Lottery/casino revenues	3,629	11	44	3,596

Other revenues	7,223	185	4	7,404
Total tax-exempt debt securities	75,946	2,008	318	77,636
Equity securities	77	—	—	77
Total available for sale securities	$266,839	$6,258	$ 970	$272,127

The below information is relative to the five states where issuers with the highest volume of state and political subdivision securities held in our portfolio are located. We own no such securities of any single issuer which we deem to be a concentration.

Table of Contents

	September 30, 2016			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Michigan	14,237	462	31	14,668
Illinois	10,167	587	2	10,752
West Virginia	8,725	157	7	8,875
Texas	8,197	371	20	8,548
Indiana	5,852	252	39	6,065

Management performs pre-purchase and ongoing analysis to confirm that all investment securities meet applicable credit quality standards. Prior to July 1, 2013, we principally used credit ratings from Nationally Recognized Statistical Rating Organizations ("NRSROs") to support analyses of our portfolio of securities issued by state and political subdivisions, as we generally do not purchase securities that are rated below the six highest NRSRO rating categories. Beginning July 1, 2013, in addition to considering a security's NRSRO rating, we now also assess or confirm through an internal review of an issuer's financial information and other applicable information that: 1) the issuer's risk of default is low; 2) the characteristics of the issuer's demographics and economic environment are satisfactory; and 3) the issuer's budgetary position and stability of tax or other revenue sources are sound.

The maturities, amortized cost and estimated fair values of securities at September 30, 2016, are summarized as follows:

Dollars in thousands	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 53,078	$ 54,009
Due from one to five years	86,572	88,289
Due from five to ten years	18,245	18,713
Due after ten years	97,606	101,014
Equity securities	77	77
	$ 255,578	$ 262,102

The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the nine months ended September 30, 2016 are as follows:

	Proceeds from			Gross realized	
Dollars in thousands	Sales	Calls and Maturities	Principal Payments	Gains	Losses
Securities available for sale	$ 63,641	$ 630	$ 27,696	$ 1,117	$ 281

We held 48 available for sale securities having an unrealized loss at September 30, 2016. 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 other-than-temporary impairment charge to earnings is warranted at this time.

Provided below is a summary of securities available for sale which were in an unrealized loss position at September 30, 2016 and December 31, 2015.

	September 30, 2016					
	Less than 12 months		12 months or more		Total	
Dollars in thousands	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	$855	$ (5)	$2,734	$ (42)	$3,589	$ (47)
Residential mortgage-backed securities:						
Government-sponsored agencies	22,900	(149)	8,853	(115)	31,753	(264)
Nongovernment-sponsored entities	—	—	3,405	(29)	3,405	(29)
Corporate debt securities	1,701	(49)	5,952	(100)	7,653	(149)
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	8,399	(115)	—	—	8,399	(115)
Water and sewer revenues	824	(11)	—	—	824	(11)
Lease revenues	1,104	(38)	—	—	1,104	(38)
Other revenues	2,396	(29)	—	—	2,396	(29)
Total temporarily impaired securities	38,179	(396)	20,944	(286)	59,123	(682)
Total other-than-temporarily impaired securities	—	—	—	—	—	—
Total	$38,179	$ (396)	$20,944	$ (286)	$59,123	$ (682)

	December 31, 2015					
	Less than 12 months		12 months or more		Total	
Dollars in thousands	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	$2,104	$ (2)	$3,151	$ (47)	$5,255	$ (49)
Residential mortgage-backed securities:						
Government-sponsored agencies	52,970	(569)	8,672	(226)	61,642	(795)
Nongovernment-sponsored entities	2,298	—	2,819	(33)	5,117	(33)
State and political subdivisions:						
Other revenues	1,702	(26)	—	—	1,702	(26)
Corporate debt securities	8,367	(268)	—	—	8,367	(268)
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	5,977	(41)	—	—	5,977	(41)
Lease revenues	576	(1)	—	—	576	(1)
Other revenues	1,218	(14)	—	—	1,218	(14)
Total temporarily impaired securities	75,212	(921)	14,642	(306)	89,854	(1,227)
Total other-than-temporarily impaired securities	—	—	—	—	—	—
Total	$75,212	$ (921)	$14,642	$ (306)	$89,854	$ (1,227)

Table of Contents

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. We categorize residential real estate loans in excess of $600,000 as jumbo loans.

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.

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	September 30, 2016	December 31, 2015	September 30, 2015
Commercial	$ 110,466	$ 97,201	$ 89,250
Commercial real estate			
Owner-occupied	192,254	203,555	199,068
Non-owner occupied	367,196	337,294	336,550
Construction and development			
Land and land development	65,430	65,500	66,164
Construction	11,276	9,970	8,419
Residential real estate			
Non-jumbo	228,777	221,750	222,739
Jumbo	57,276	50,313	46,092
Home equity	75,161	74,300	73,652
Mortgage warehouse lines	108,983	—	—
Consumer	19,756	19,251	19,124
Other	9,649	11,669	12,518
Total loans, net of unearned fees	1,246,224	1,090,803	1,073,576
Less allowance for loan losses	11,619	11,472	11,228
Loans, net	$ 1,234,605	$ 1,079,331	$ 1,062,348

Table of Contents

The following table presents the contractual aging of the recorded investment in past due loans by class as of September 30, 2016 and 2015 and December 31, 2015.

	At September 30, 2016					
	Past Due					> 90 days
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	and Accruing
Commercial	$301	$138	$602	$1,041	$109,425	$ —
Commercial real estate						
Owner-occupied	251	—	505	756	191,498	—
Non-owner occupied	311	78	—	389	366,807	—
Construction and development						
Land and land development	238	—	3,731	3,969	61,461	—
Construction	—	—	—	—	11,276	—
Residential mortgage						
Non-jumbo	1,932	1,488	2,762	6,182	222,595	—
Jumbo	—	—	—	—	57,276	—
Home equity	—	136	318	454	74,707	—
Mortgage warehouse lines	—	—	—	—	108,983	—
Consumer	135	44	148	327	19,429	21
Other	—	—	—	—	9,649	—
Total	$3,168	$1,884	$8,066	$13,118	$1,233,106	$ 21

	At December 31, 2015					
	Past Due					> 90 days
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	and Accruing
Commercial	$345	$26	$632	$1,003	$96,198	$ —
Commercial real estate						
Owner-occupied	158	386	437	981	202,574	—
Non-owner occupied	1	—	856	857	336,437	—
Construction and development						
Land and land development	1,182	194	4,547	5,923	59,577	—
Construction	—	—	—	—	9,970	—
Residential mortgage						
Non-jumbo	2,276	2,647	1,591	6,514	215,236	—
Jumbo	—	—	—	—	50,313	—
Home equity	374	172	100	646	73,654	—
Consumer	155	41	92	288	18,963	9
Other	—	—	—	—	11,669	—
Total	$4,491	$3,466	$8,255	$16,212	$1,074,591	$ 9

Table of Contents

	At September 30, 2015					
	Past Due					> 90 days
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	and Accruing
Commercial	$42	$41	$623	$706	$88,544	$ —
Commercial real estate						
Owner-occupied	961	—	436	1,397	197,671	—
Non-owner occupied	309	657	188	1,154	335,396	—
Construction and development						
Land and land development	39	—	4,538	4,577	61,587	—
Construction	—	—	—	—	8,419	—
Residential mortgage						
Non-jumbo	3,239	1,108	2,065	6,412	216,327	—
Jumbo	—	—	—	—	46,092	—
Home equity	165	209	27	401	73,251	—
Consumer	169	77	42	288	18,836	8
Other	—	—	—	—	12,518	—
Total	$4,924	$2,092	$7,919	$14,935	$1,058,641	$ 8

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at September 30, 2016, December 31, 2015 and September 30, 2015.

	September 30,		December 31,
Dollars in thousands	2016	2015	2015
Commercial	$846	$884	$ 853
Commercial real estate			
Owner-occupied	505	437	437
Non-owner occupied	4,362	4,858	5,518
Construction and development			
Land & land development	4,360	5,346	5,623
Construction	—	—	—
Residential mortgage			
Non-jumbo	3,680	3,689	2,987
Jumbo	—	—	—
Home equity	494	191	258
Mortgage warehouse lines	—	—	—
Consumer	148	44	83
Total	$14,395	$15,449	$ 15,759

Impaired loans: Impaired loans include the following:

Loans which we risk-rate (consisting of loan relationships having aggregate balances in excess of $2.5 million, 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.

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.

Table of Contents

Method Used to Measure Impairment of Impaired Loans
Dollars in thousands

	September 30,		December 31,	Method used to measure impairment
Loan Category	2016	2015	2015	
Commercial	$650	$41	$ 41	Fair value of collateral
	159	269	201	Discounted cash flow
Commercial real estate				
Owner-occupied	318	795	783	Fair value of collateral
	7,095	7,646	7,616	Discounted cash flow
Non-owner occupied	4,596	5,924	5,728	Fair value of collateral
	7,121	7,775	7,722	Discounted cash flow
Construction and development				
Land & land development	5,191	10,047	6,597	Fair value of collateral
	2,131	2,257	2,177	Discounted cash flow
Residential mortgage				
Non-jumbo	1,732	1,730	1,753	Fair value of collateral
	4,748	4,375	4,378	Discounted cash flow
Jumbo	3,682	3,792	3,869	Fair value of collateral
	859	876	871	Discounted cash flow
Home equity	190	186	186	Fair value of collateral
	523	523	523	Discounted cash flow
Consumer	—	2	—	Fair value of collateral
	48	68	68	Discounted cash flow
Total	$39,043	$46,306	$ 42,513	

Table of Contents

The following tables present loans individually evaluated for impairment at September 30, 2016, December 31, 2015 and September 30, 2015.

	September 30, 2016				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$791	$790	$ —	$400	$ 9
Commercial real estate					
Owner-occupied	4,914	4,914	—	4,932	188
Non-owner occupied	10,394	10,396	—	10,831	456
Construction and development					
Land & land development	6,181	6,181	—	6,207	104
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	3,852	3,861	—	3,732	170
Jumbo	3,683	3,682	—	3,711	176
Home equity	713	713	—	710	21
Mortgage warehouse lines	—	—	—	—	—
Consumer	48	48	—	52	5
Total without a related allowance	$30,576	$30,585	$ —	$30,575	$ 1,129
With a related allowance					
Commercial	$19	$19	$ 19	$6	$ —
Commercial real estate					
Owner-occupied	2,499	2,499	12	2,491	112
Non-owner occupied	1,321	1,321	132	1,332	43
Construction and development					
Land & land development	1,140	1,141	492	1,155	58
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,617	2,619	216	2,329	103
Jumbo	859	859	25	864	43
Home equity	—	—	—	—	—
Mortgage warehouse lines	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$8,455	$8,458	$ 896	$8,177	$ 359
Total					
Commercial	$27,259	$27,261	$ 655	$27,354	$ 970
Residential real estate	11,724	11,734	241	11,346	513
Consumer	48	48	—	52	5
Total	$39,031	$39,043	$ 896	$38,752	$ 1,488

Table of Contents
25

	December 31, 2015				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$242	$242	$ —	$319	$ 17
Commercial real estate					
Owner-occupied	5,401	5,402	—	5,438	191
Non-owner occupied	10,740	10,741	—	9,982	310
Construction and development					
Land & land development	7,635	7,635	—	9,497	263
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	3,590	3,600	—	3,316	160
Jumbo	3,871	3,869	—	4,412	181
Home equity	709	709	—	709	32
Consumer	68	68	—	72	6
Total without a related allowance	$32,256	$32,266	$ —	$33,745	$ 1,160
With a related allowance					
Commercial	$—	$—	$ —	$—	$ —
Commercial real estate					
Owner-occupied	2,997	2,997	45	3,003	135
Non-owner occupied	2,709	2,709	386	2,728	72
Construction and development					
Land & land development	1,139	1,139	85	1,154	—
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,530	2,531	226	2,552	114
Jumbo	871	871	34	878	43
Home equity	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$10,246	$10,247	$ 776	$10,315	$ 364
Total					
Commercial	$30,863	$30,865	$ 516	$32,121	$ 988
Residential real estate	11,571	11,580	260	11,867	530
Consumer	68	68	—	72	6
Total	$42,502	$42,513	$ 776	$44,060	$ 1,524

	September 30, 2015				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	$310	$310	$ —	$345	$ 63
Commercial real estate					
Owner-occupied	5,420	5,421	—	5,450	586
Non-owner occupied	11,635	11,636	—	10,362	988
Construction and development					
Land & land development	12,136	12,304	—	11,282	908
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	3,399	3,408	—	3,930	462
Jumbo	3,794	3,792	—	3,820	554
Home equity	710	709	—	709	93
Consumer	70	70	—	75	21
Total without a related allowance	$37,474	$37,650	$ —	$35,973	$ 3,675
With a related allowance					
Commercial	$—	$—	$ —	$—	$ —
Commercial real estate					
Owner-occupied	3,019	3,020	46	3,005	409
Non-owner occupied	2,063	2,063	190	2,074	244
Construction and development					
Land & land development	—	—	—	—	—
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,695	2,697	251	2,714	348
Jumbo	876	876	37	880	134
Home equity	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	$8,653	$8,656	$ 524	$8,673	$ 1,135
Total					
Commercial	$34,583	$34,754	$ 236	$32,518	$ 3,198
Residential real estate	11,474	11,482	288	12,053	1,591
Consumer	70	70	—	75	21
Total	$46,127	$46,306	$ 524	$44,646	$ 4,810

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 be classified as a TDR for the life of the loan. Included in impaired loans are TDRs of $29.2 million, of which $28.5 million were current with respect to restructured contractual payments at September 30, 2016, and $30.5 million, of which $28.9 million were current with respect to restructured contractual payments at December 31, 2015. There were 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 and nine months ended September 30, 2016 and September 30, 2015 . 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.

Dollars in thousands	For the Three Months Ended September 30, 2016 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment	For the Three Months Ended September 30, 2015 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment
Commercial	—	$ —	$ —	—	$ —	$ —
Commercial real estate						
Owner-occupied	—	—	—	—	—	—
Non-owner occupied	—	—	—	—	—	—
Construction and development						
Land & land development	—	—	—	1	1,182	1,182
Construction	—	—	—	—	—	—
Residential real estate						
Non-jumbo	1	307	307	—	—	—
Jumbo	—	—	—	—	—	—
Home equity	—	—	—	—	—	—
Mortgage warehouse lines	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total	1	$ 307	$ 307	1	$ 1,182	$ 1,182

Dollars in thousands	For the Nine Months Ended September 30, 2016 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment	For the Nine Months Ended September 30, 2015 Number of Modifications	Pre-modification Recorded Investment	Post-modification Recorded Investment
Commercial	—	$ —	$ —	—	$ —	$ —
Commercial real estate						
Owner-occupied	—	—	—	—	—	—
Non-owner occupied	—	—	—	—	—	—
Construction and development						
Land & land development	—	—	—	1	1,182	1,182
Construction	—	—	—	—	—	—
Residential real estate						
Non-jumbo	4	702	702	—	—	—
Jumbo	—	—	—	—	—	—
Home equity	—	—	—	—	—	—
Mortgage warehouse lines	—	—	—	—	—	—
Consumer	1	2	2	—	—	—
Total	5	$ 704	$ 704	1	$ 1,182	$ 1,182

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.

	For the Three Months Ended September 30, 2016		For the Nine Months Ended September 30, 2016	
Dollars in thousands	Number of Defaults	Recorded Investment at Default Date	Number of Defaults	Recorded Investment at Default Date
Commercial	—	$ —	—	$ —
Commercial real estate				
Owner-occupied	—	—	—	—
Non-owner occupied	—	—	—	—
Construction and development				
Land & land development	—	—	—	—
Construction	—	—	—	—
Residential real estate				
Non-jumbo	3	452	3	452
Jumbo	—	—	—	—
Home equity	—	—	—	—
Mortgage warehouse lines	—	—	—	—
Consumer	1	2	1	2
Total	4	$ 454	4	$ 454

The following table details the activity regarding TDRs by loan type for the three months and nine months ended September 30, 2016, and the related allowance on TDRs.

For the Three Months Ended September 30, 2016

	Construction & Land Development			Commercial Real Estate		Residential Real Estate						
Dollars in thousands	Land & Land Develop-ment	Construc-tion	Commer-cial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Mortgage Warehouse Lines	Con-sumer	Other	Total
Troubled debt restructurings												
Balance July 1, 2016	$ 3,956	$ —	$ 198	$ 9,118	$ 6,001	$ 5,457	$ 4,575	$ 523	$ —	$ 54	$ —	$ 29,882
Additions	—	—	—	—	—	303	—	—	—	—	—	303
Charge-offs	—	—	—	(2)	—	—	—	—	—	—	—	(2)
Net (paydowns) advances	(57)	—	(7)	(381)	(504)	(44)	(34)	—	—	(6)	—	(1,033)
Transfer into foreclosed properties	—	—	—	—	—	—	—	—	—	—	—	—
Refinance out of TDR status	—	—	—	—	—	—	—	—	—	—	—	—
Balance, September 30, 2016	$ 3,899	$ —	$ 191	$ 8,735	$ 5,497	$ 5,716	$ 4,541	$ 523	$ —	$ 48	$ —	$ 29,150

Allowance related to troubled debt restructurings	$ 492	$ —	$ —	$ 144	$ —	$ 216	$ 25	$ —	$ —	$ —	$ —	$ 877

Table of Contents

For the Nine Months Ended September 30, 2016

	Construction & Land Development			Commercial Real Estate		Residential Real Estate						
Dollars in thousands	Land & Land Develop- ment	Construc- tion	Commer- cial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Mortgage Warehouse Lines	Con- sumer	Other	Total
Troubled debt restructurings												
Balance January 1, 2016	$ 4,188	$ —	$ 242	$ 9,314	$ 6,059	$ 5,496	$ 4,634	$ 523	$ —	$ 68	$ —	$ 30,524
Additions	—	—	—	—	—	698	—	—	—	1	—	699
Charge-offs	—	—	—	(128)	—	(52)	—	—	—	—	—	(180)
Net (paydowns) advances	(289)	—	(51)	(451)	(562)	(426)	(93)	—	—	(21)	—	(1,893)
Transfer into foreclosed properties	—	—	—	—	—	—	—	—	—	—	—	—
Refinance out of TDR status	—	—	—	—	—	—	—	—	—	—	—	—
Balance, September 30, 2016	$ 3,899	$ —	$ 191	$ 8,735	$ 5,497	$ 5,716	$ 4,541	$ 523	$ —	$ 48	$ —	$ 29,150
Allowance related to troubled debt restructurings	$ 492	$ —	$ —	$ 144	$ —	$ 216	$ 25	$ —	$ —	$ —	$ —	$ 877

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 $2.5 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.

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.

The following table presents the recorded investment in construction and development, commercial, and commercial real estate loans which are generally evaluated based upon the internal risk ratings defined above.

Table of Contents

Loan Risk Profile by Internal Risk Rating

	Construction and Development						Commercial Real Estate					
	Land and Land Development		Construction		Commercial		Owner Occupied		Non-Owner Occupied		Mortgage Warehouse Lines	
Dollars in thousands	9/30/2016	12/31/2015	9/30/2016	12/31/2015	9/30/2016	12/31/2015	9/30/2016	12/31/2015	9/30/2016	12/31/2015	9/30/2016	12/31
Pass	$58,169	$57,155	$11,276	$9,970	$108,563	$95,174	$190,854	$202,226	$361,531	$329,861	$108,983	$—
OLEM (Special Mention)	1,737	1,598	—	—	1,142	1,295	576	546	958	1,602	—	—
Substandard	5,524	6,747	—	—	761	732	824	783	4,707	5,831	—	—
Doubtful	—	—	—	—	—	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	—	—	—	—	—	—
Total	$65,430	$65,500	$11,276	$9,970	$110,466	$97,201	$192,254	$203,555	$367,196	$337,294	$108,983	$—

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.

	Performing			Nonperforming		
Dollars in thousands	9/30/2016	12/31/2015	9/30/2015	9/30/2016	12/31/2015	9/30/2015
Residential real estate						
Non-jumbo	$225,097	$ 218,763	$219,050	$3,680	$ 2,987	$ 3,689
Jumbo	57,276	50,313	46,092	—	—	—
Home Equity	74,667	74,042	73,461	494	258	191
Consumer	19,574	19,149	19,071	182	102	53
Other	9,649	11,669	12,518	—	—	—
Total	$386,263	$ 373,936	$370,192	$4,356	$ 3,347	$ 3,933

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.

NOTE 7. ALLOWANCE FOR LOAN LOSSES

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

Specific Reserve for Loans Individually Evaluated

First, we identify loan relationships having aggregate balances in excess of $500,000 and that may also have credit weaknesses. Such loan relationships are identified primarily through our analysis of internal loan evaluations, past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – that is, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of our impaired loans historically have been collateral dependent, meaning repayment of the loan is expected or is considered 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. Beginning in 2014, for purposes of loans that have been modified in a troubled debt restructuring and not internally graded as substandard, doubtful, or loss ("performing TDRs") we began measuring impairment using the discounted cash flows method. Under this method, a specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over its discounted cash flows.

Quantitative Reserve for Loans Collectively Evaluated

Second, we stratify the loan portfolio into the following eleven 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, mortgage warehouse lines, consumer, and other. Quantitative reserves

Table of Contents

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 eleven 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.

An analysis of the allowance for loan losses for the nine month periods ended September 30, 2016 and 2015, and for the year ended December 31, 2015 is as follows:

	Nine Months Ended September 30,		Year Ended December 31,
Dollars in thousands	2016	2015	2015
Balance, beginning of year	$11,472	$11,167	$ 11,167
Losses:			
Commercial	379	77	77
Commercial real estate			
Owner occupied	179	559	559
Non-owner occupied	122	178	178
Construction and development			
Land and land development	50	457	457
Construction	—	—	—
Residential real estate			
Non-jumbo	119	316	417
Jumbo	—	206	208
Home equity	117	76	76
Mortgage warehouse lines	—	—	—
Consumer	61	62	69
Other	128	88	110
Total	1,155	2,019	2,151
Recoveries:			
Commercial	69	6	10
Commercial real estate			
Owner occupied	25	282	290
Non-owner occupied	13	6	13
Construction and development			
Land and land development	514	454	456
Construction	—	—	—
Real estate - mortgage			
Non-jumbo	58	90	107

Jumbo	6	96	96
Home equity	3	3	3
Mortgage warehouse lines	—	—	—
Consumer	55	88	105
Other	59	55	126
Total	802	1,080	1,206
Net losses	353	939	945
Provision for loan losses	500	1,000	1,250
Balance, end of period	$11,619	$11,228	$ 11,472

Table of Contents

Activity in the allowance for loan losses by loan class during the first nine months of 2016 is as follows:

	Construction & Land Development		Commercial Real Estate		Residential Real Estate							
Dollars in thousands	Land & Land Develop- ment	Construc- tion	Commer- cial	Owner Occupied	Non- Owner Occupied	Non- jumbo	Jumbo	Home Equity	Mortgage Warehouse Lines	Con- sumer	Other	Tot
Allowance for loan losses												
Beginning balance	$2,852	$15	$780	$1,589	$2,977	$1,253	$1,593	$253	$—	$60	$100	$1
Charge-offs	50	—	379	179	122	119	—	117	—	61	128	1,1
Recoveries	514	—	69	25	13	58	6	3	—	55	59	802
Provision	(1,814)	9	734	543	1,097	694	(1,157)	267	—	37	90	500
Ending balance	$1,502	$24	$1,204	$1,978	$3,965	$1,886	$442	$406	$—	$91	$121	$1
Allowance related to:												
Loans individually evaluated for impairment	$493	$—	$19	$12	$132	$216	$25	$—	$—	$—	$—	$8
Loans collectively evaluated for impairment	1,009	24	1,185	1,966	3,833	1,670	417	406	—	91	121	10,
Total	$1,502	$24	$1,204	$1,978	$3,965	$1,886	$442	$406	$—	$91	$121	$1
Loans												
Loans individually evaluated for impairment	$7,322	$—	$809	$7,413	$11,717	$6,480	$4,541	$713	$—	$48	$—	$3
Loans collectively evaluated for impairment	58,108	11,276	109,657	184,841	355,479	222,297	52,735	74,448	108,983	19,708	9,649	1,2
Total	$65,430	$11,276	$110,466	$192,254	$367,196	$228,777	$57,276	$75,161	$108,983	$19,756	$9,649	$1,

NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

The following tables present our goodwill by reporting unit at September 30, 2016 and other intangible assets by reporting unit at September 30, 2016 and December 31, 2015.

	Goodwill Activity		
Dollars in thousands	Community Banking	Insurance Services	Total

Balance, January 1, 2016	$1,488	$ 4,710	$6,198
Acquired goodwill, net	—	—	—
Balance, September 30, 2016	$1,488	$ 4,710	$6,198

	Other Intangible Assets					
	September 30, 2016			December 31, 2015		
Dollars in thousands	Community Banking	Insurance Services	Total	Community Banking	Insurances Services	Total
Unidentifiable intangible assets						
Gross carrying amount	$2,268	$ —	$2,268	$2,268	$ —	$2,268
Less: accumulated amortization	2,268	—	2,268	2,268	—	2,268
Net carrying amount	$—	$ —	$—	$—	$ —	$—
Identifiable intangible assets						
Gross carrying amount	$—	$ 3,000	$3,000	$—	$ 3,000	$3,000
Less: accumulated amortization	—	1,850	1,850	—	1,700	1,700
Net carrying amount	$—	$ 1,150	$1,150	$—	$ 1,300	$1,300

We recorded amortization expense of approximately $150,000 for the nine months ended September 30, 2016 relative to our other intangible assets. Annual amortization is expected to approximate $200,000 for each of the years ending 2016 through 2020.

Table of Contents

NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of September 30, 2016 and 2015 and December 31, 2015:

Dollars in thousands	September 30, 2016	December 31, 2015	September 30, 2015
Demand deposits, interest bearing	$ 212,172	$ 215,721	$ 217,242
Savings deposits	321,563	266,825	259,185
Time deposits	500,397	465,153	476,777
Total	$ 1,034,132	$ 947,699	$ 953,204

Included in time deposits are deposits acquired through a third party ("brokered deposits") totaling $178.9 million, $126.5 million and $132.0 million at September 30, 2016, December 31, 2015, and September 30, 2015, respectively.

A summary of the scheduled maturities for all time deposits as of September 30, 2016 is as follows:

Dollars in thousands	
Three month period ending December 31, 2016	$68,598
Year ending December 31, 2017	200,514
Year ending December 31, 2018	85,847
Year ending December 31, 2019	50,217
Year ending December 31, 2020	41,697
Thereafter	53,524
Total	$500,397

The following is a summary of the maturity distribution of all certificates of deposit in denominations of $100,000 or more as of September 30, 2016:

Dollars in thousands	Amount	Percent
Three months or less	$49,747	12.8 %
Three through six months	42,758	11.0 %
Six through twelve months	85,427	22.0 %
Over twelve months	210,358	54.2 %
Total	$388,290	100.00%

NOTE 10. BORROWED FUNDS

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

	Nine Months Ended September 30,			
	2016		2015	
Dollars in thousands	Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit	Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit
Balance at September 30	$231,200	$3,457	$141,850	$3,441
Average balance outstanding for the period	177,239	3,455	144,073	5,104
Maximum balance outstanding at any month end during period	231,200	3,457	171,160	7,438
Weighted average interest rate for the period	0.54 %	0.50 %	0.42 %	0.25 %

Weighted average interest rate for balances outstanding at September 30	0.59 %	0.50 %	0.33 %	0.25 %

Table of Contents

Dollars in thousands	Year Ended December 31, 2015 Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit
Balance at December 31	$167,950	$3,444
Average balance outstanding for the period	146,412	4,690
Maximum balance outstanding at any month end during period	171,160	7,438
Weighted average interest rate for the period	0.43 %	0.50 %
Weighted average interest rate for balances outstanding at December 31	0.35 %	0.26 %

Long-term borrowings: Our long-term borrowings of $74.1 million, $75.6 million and $76.1 million at September 30, 2016, December 31, 2015, and September 30, 2015 respectively, consisted primarily of advances from the Federal Home Loan Bank ("FHLB") and structured reverse repurchase agreements with two unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

	Balance at September 30,		Balance at December 31,
Dollars in thousands	2016	2015	2015
Long-term FHLB advances	$792	$900	$ 873
Long-term reverse repurchase agreements	72,000	72,000	72,000
Term loan	1,354	3,159	2,708
Total	$74,146	$76,059	$ 75,581

The term loan at September 30, 2016 is secured by the common stock of our subsidiary bank and bears a variable interest rate of prime minus 50 basis points with a final maturity of 2017. Our long term FHLB borrowings and reverse repurchase agreements bear both fixed and variable rates and mature in varying amounts through the year 2026.

The average interest rate paid on long-term borrowings for the nine month period ended September 30, 2016 was 4.43% compared to 4.37% for the first nine months of 2015.

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 $19.6 million at September 30, 2016, December 31, 2015, and September 30, 2015.

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 $3.5 million in capital securities and $109,000 in common securities and invested the proceeds in $3.61 million of debentures. SFG Capital Trust II issued $7.5 million in capital securities and $232,000 in common securities and invested the proceeds in $7.73 million of debentures. SFG Capital Trust III issued $8.0 million in capital securities and $248,000 in common securities and invested the proceeds in $8.25 million 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 345basis points for SFG Capital Trust I, 3 month LIBOR plus 280basis points for SFG

Capital Trust II, and 3 month LIBOR plus 145basis 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:

Table of Contents

Dollars in thousands		Long-term borrowings	Subordinated debentures owed to unconsolidated subsidiary trusts
Year Ending December 31,	2016	$ 27,476	$ —
	2017	918	—
	2018	45,017	—
	2019	18	—
	2020	19	—
	Thereafter	698	19,589
		$ 74,146	$ 19,589

NOTE 11. SHARE-BASED COMPENSATION

The 2014 Long-Term Incentive Plan (“2014 LTIP”) was adopted by our shareholders in May 2014 to enhance the ability of the Company to attract and retain exceptionally qualified individuals to serve as key employees. The LTIP provides for the issuance of up to 500,000 shares of common stock, in the form of equity awards including stock options, restricted stock, restricted stock units, stock appreciation rights ("SARs"), performance units, other stock-based awards or any combination thereof, to our key employees.

Stock options awarded under the 2009 Officer Stock Option Plan and the 1998 Officer Stock Option Plan (collectively, the “Plans”) were not altered by the 2014 LTIP, and remain subject to the terms of the Plans. However, under the terms of the 2014 LTIP, all shares of common stock remaining issuable under the Plans at the time the 2014 LTIP was adopted ceased to be available for future issuance.

Under the 2014 LTIP and the Plans, stock options and SARs have generally been granted with an exercise price equal to the fair value of Summit's common stock on the grant date. We periodically grant employee stock options to individual employees. During second quarter 2015, we granted 166,717 SARs that become exercisable ratably over five years (20% per year) and expire ten years after the grant date. There were no grants of stock options or SARs during the first nine months of 2016.

The fair value of our employee stock options and SARs granted under the Plans 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 and SARs granted but are not considered by the model. Because our employee stock options and SARs 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 and SARs at the time of grant. The assumptions used to value SARs issued during 2015 were a risk-free interest rate of 1.96%, an expected dividend yield of 2.75%, an expected common stock volatility of 61.84%, and an expected life of 10 years.

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 nine months of 2016 and 2015, our stock compensation expense and related deferred taxes were insignificant.

A summary of activity in our Plans during the first nine months of 2016 and 2015 is as follows:

	For the Nine Months Ended September 30,			
	2016		2015	
	Options/SARs	Weighted-Average Exercise Price	Options/SARs	Weighted-Average Exercise Price
Outstanding, January 1	244,147	$ 14.05	157,170	$ 20.43
Granted	—	—	166,717	12.01
Exercised	—	—	—	—
Forfeited	—	—	—	—
Expired	—	—	—	—
Outstanding, September 30	244,147	$ 14.05	323,887	$ 16.10

Table of Contents

Other information regarding awards outstanding and exercisable at September 30, 2016 is as follows:

	Options/SARs Outstanding				Options/SARs Exercisable		
Range of exercise price	# of awards	WAEP	Wted. Avg. Remaining Contractual Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of awards	WAEP	Aggregate Intrinsic Value (in thousands)
$2.54 - $6.00	7,750	$ 3.75	4.43	$ 119	7,750	$ 3.75	$ 119
6.01 - 10.00	12,680	8.71	1.90	133	12,680	8.71	133
10.01 - 17.50	166,717	12.01	8.57	1,192	33,343	12.01	238
17.51 - 20.00	23,400	17.80	1.26	32	23,400	17.80	32
20.01 - 25.93	33,600	25.93	1.69	—	33,600	25.93	—
	244,147	14.05		$ 1,476	110,773	—	$ 522

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:

Dollars in thousands	September 30, 2016
Commitments to extend credit:	
Revolving home equity and credit card lines	$ 59,974
Construction loans	26,839
Other loans	102,185
Standby letters of credit	2,888
Total	$ 191,886

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

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

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

Legal Contingencies

On May 13, 2014, the ResCap Liquidating Trust ("ResCap"), as successor to Residential Funding Company, LLC f/k/a Residential Funding Corporation ("RFC"), filed a complaint against Summit Financial Mortgage, LLC ("Summit Mortgage"), a former residential mortgage subsidiary of Summit whose operations were discontinued in 2007, in the United States Bankruptcy Court for the Southern District of New York and subsequently amended its complaint on July 25, 2014. The Amended Complaint asserts the following three causes of action related to Summit Mortgage's origination and subsequent sale of mortgage loans to Residential Funding Corporation: 1) Summit Mortgage breached its representations and warranties made in the contract governing the sale of the mortgage loans to RFC; 2) an indemnification claim against Summit Mortgage for damages paid by ResCap to settle claims in RFC's bankruptcy proceeding which allegedly relate to mortgage loans Summit Mortgage sold to RFC; 3) a claim for damages against Summit Community Bank, Inc., former parent of Summit Mortgage, arising out of a guaranty in which the Bank guaranteed Summit Mortgage's full performance under the contract governing the sale of mortgage loans to RFC. Summit has filed a motion to dismiss the case. Based upon the applicable statute of limitations, the Court granted our motion to dismiss the breach of contract claim with respect to loans Summit sold to RFC prior to March 14, 2006. The court otherwise denied our motion to dismiss on the grounds that the other arguments raised factual questions that could not be decided on a motion to dismiss. An estimate as to possible loss resulting from the Amended Complaint cannot be provided at this time because such an estimate cannot be made. Summit intends to defend these claims vigorously.

We are not a party to any other litigation except for matters that arise in the normal course of business. While it is impossible to ascertain the ultimate resolution or range of financial liability with respect to these contingent matters, in the opinion of management, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

NOTE 13. REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). We believe, as of September 30, 2016, 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.
The Basel III Capital Rules became effective for us on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of September 30, 2016, our capital levels remained characterized as "well-capitalized" under the new rules. See the Capital Requirements section included in Part I Item 1 Business of our 2015 Annual Report on Form 10-K for further discussion of Basel III.

The following table presents Summit's, as well as our subsidiary, Summit Community Bank's ("Summit Community"), actual and required minimum capital amounts and ratios as of September 30, 2016 and December 31, 2015 under the Basel III Capital Rules. The minimum required capital levels presented below reflect the minimum required capital levels (inclusive of the full capital conservation buffers) that will be effective as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

	Actual		Minimum Required Capital - Basel III Fully Phased-in		Minimum Required To Be Well Capitalized	
Dollars in thousands	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2016						
CET1 (to risk weighted assets)						
Summit	$147,791	11.1%	$93,202	7.0 %	$86,544	6.5 %
Summit Community	166,332	12.5%	93,146	7.0 %	86,493	6.5 %
Tier I Capital (to risk weighted assets)						
Summit	164,707	12.4%	112,904	8.5 %	106,263	8.0 %
Summit Community	166,332	12.5%	113,106	8.5 %	106,452	8.0 %
Total Capital (to risk weighted assets)						
Summit	176,326	13.3%	139,205	10.5%	132,576	10.0%
Summit Community	177,951	13.4%	139,439	10.5%	132,799	10.0%
Tier I Capital (to average assets)						
Summit	164,707	10.4%	63,349	4.0 %	79,186	5.0 %
Summit Community	166,332	10.5%	63,365	4.0 %	79,206	5.0 %

	Actual		Minimum Required Capital - Basel III Fully Phased-in		Minimum Required To Be Well Capitalized	
Dollars in thousands	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015						
CET1 (to risk weighted assets)						
Summit	137,849	11.8%	81,775	7.0 %	75,934	6.5 %
Summit Community	158,081	13.6%	81,365	7.0 %	75,553	6.5 %
Tier I Capital (to risk weighted assets)						
Summit	156,849	13.4%	99,494	8.5 %	93,641	8.0 %
Summit Community	158,081	13.6%	98,801	8.5 %	92,989	8.0 %
Total Capital (to risk weighted assets)						
Summit	168,321	14.4%	122,734	10.5%	116,890	10.0%
Summit Community	169,553	14.5%	122,780	10.5%	116,933	10.0%
Tier I Capital (to average assets)						
Summit	156,849	10.7%	58,635	4.0 %	73,294	5.0 %
Summit Community	158,081	10.8%	58,549	4.0 %	73,186	5.0 %

NOTE 14. SEGMENT INFORMATION

We operate two business segments: community banking and insurance & financial 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 & financial services segment includes 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.

Table of Contents

Inter-segment revenue and expense consists of management fees allocated to the community banking and the insurance & financial services segments 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:

	Nine Months Ended September 30, 2016				
Dollars in thousands	Community Banking	Insurance & Financial Services	Parent	Eliminations	Total
Net interest income (loss)	$36,028	$ —	$(478)	$—	$35,550
Provision for loan losses	500	—	—	—	500
Net interest income (loss) after provision for loan losses	35,528	—	(478)	—	35,050
Other income	5,240	3,361	1,166	(1,166)	8,601
Other expenses	21,735	3,106	1,735	(1,166)	25,410
Income (loss) before income taxes	19,033	255	(1,047)	—	18,241
Income tax expense (benefit)	5,897	95	(337)	—	5,655
Net income (loss)	$13,136	$ 160	$(710)	$—	$12,586
Inter-segment revenue (expense)	$(1,081)	$ (85)	$1,166	$—	$—
Average assets	$1,565,099	$ 5,951	$172,840	$(199,962)	$1,543,928

	Nine Months Ended September 30, 2015				
Dollars in thousands	Community Banking	Insurance & Financial Services	Parent	Eliminations	Total
Net interest income (loss)	$34,861	$ —	$(578)	$—	$34,283
Provision for loan losses	1,000	—	—	—	1,000
Net interest income (loss) after provision for loan losses	33,861	—	(578)	—	33,283
Other income	5,371	3,621	850	(850)	8,992
Other expenses	20,961	3,204	1,823	(850)	25,138
Income (loss) before income taxes	18,271	417	(1,551)	—	17,137
Income tax expense (benefit)	5,577	115	(511)	—	5,181
Net income (loss)	$12,694	$ 302	$(1,040)	$—	$11,956
Inter-segment revenue (expense)	$(785)	$ (65)	$850	$—	$—
Average assets	$1,493,759	$ 5,932	$167,973	$(205,059)	$1,462,605

Table of Contents

Dollars in thousands	Three Months Ended September 30, 2016 Community Banking	Insurance & Financial Services	Parent	Eliminations	Total
Net interest income (loss)	$12,197	$ —	$(160)	$—	$12,037
Provision for loan losses	—	—	—	—	—
Net interest income (loss) after provision for loan losses	12,197	—	(160)	—	12,037
Other income	1,622	1,127	389	(389)	2,749
Other expenses	7,249	1,002	557	(389)	8,419
Income (loss) before income taxes	6,570	125	(328)	—	6,367
Income tax expense (benefit)	2,155	40	(109)	—	2,086
Net income (loss)	$4,415	$ 85	$(219)	$—	$4,281
Inter-segment revenue (expense)	$(361)	$ (28)	$389	$—	$—
Average assets	$1,609,343	$ 6,005	$175,581	$(201,875)	$1,589,054

Dollars in thousands	Three Months Ended September 30, 2015 Community Banking	Insurance & Financial Services	Parent	Eliminations	Total
Net interest income (loss)	$11,468	$ —	$(163)	$—	$11,305
Provision for loan losses	250	—	—	—	250
Net interest income (loss) after provision for loan losses	11,218	—	(163)	—	11,055
Other income	1,882	1,111	283	(283)	2,993
Other expenses	7,515	1,045	595	(283)	8,872
Income (loss) before income taxes	5,585	66	(475)	—	5,176
Income tax expense (benefit)	1,639	15	(139)	—	1,515
Net income (loss)	$3,946	$ 51	$(336)	$—	$3,661
Inter-segment revenue (expense)	$(262)	$ (21)	$283	$—	$—
Average assets	$1,494,933	$ 5,949	$167,633	$(201,522)	$1,466,993

NOTE 15. DERIVATIVE FINANCIAL INSTRUMENTS

We use derivative instruments primarily to protect against the risk of adverse interest rate movements on the cash flows of certain liabilities and the fair values of certain assets. Derivative instruments represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash or another type of asset to the other party based upon a notional amount and an underlying as specified in the contract. A notional amount represents the number of units of a specific item, such as currency units. An underlying represents a variable, such as an interest rate or price index. The amount of cash or other asset delivered from one party to the other is determined based upon the interaction of the notional amount of the contract with the underlying. Derivatives can also be implicit in certain contracts and commitments.

As with any financial instrument, derivative instruments have inherent risks, primarily market and credit risk. Market risk associated with changes in interest rates is managed by establishing and monitoring limits as to the degree of risk that may be undertaken as part of our overall market risk monitoring process. Credit risk occurs when a counterparty to a derivative contract with an unrealized gain fails to perform according to the terms of the agreement. Credit risk is managed by monitoring the size and maturity structure of the derivative portfolio, and applying uniform credit standards to all activities with credit risk.

Table of Contents

In accordance with ASC 815, Derivatives and Hedging, all derivative instruments are recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction.

Fair-value hedges – For transactions in which we are hedging changes in fair value of an asset, liability, or a firm commitment, changes in the fair value of the derivative instrument are generally offset in the income statement by changes in the hedged item's fair value.

Cash-flow hedges – For transactions in which we are hedging the variability of cash flows related to a variable-rate asset, liability, or a forecasted transaction, changes in the fair value of the derivative instrument are reported in other comprehensive income. The gains and losses on the derivative instrument, which are reported in comprehensive income, are reclassified to earnings in the periods in which earnings are impacted by the variability of cash flows of the hedged item.

The ineffective portion of all hedges is recognized in current period earnings.

Other derivative instruments – For risk management purposes that do not meet the hedge accounting criteria and, therefore, do not qualify for hedge accounting. These derivative instruments are accounted for at fair value with changes in fair value recorded in the income statement.

We have entered into three forward-starting, pay-fixed/receive LIBOR interest rate swaps. $40 million notional with an effective date of July 18, 2016, was designated as a cash flow hedge of $40 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of this swap we will pay a fixed rate of 2.98% for a 3 year period. $30 million notional with an effective date of April 18, 2016, was designated as a cash flow hedge of $30 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of this swap we will pay a fixed rate of 2.89% for a 4.5 year period. $40 million notional with an effective date of October 18, 2016, was designated as a cash flow hedge of $40 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of the swap we will pay a fixed rate of 2.84% for a 3 year period.

We have entered into two pay fixed/receive variable interest rate swaps to hedge fair value variability of two commercial fixed rate loans with the same principal, amortization, and maturity terms of the underlying loans, which are designated as fair value hedges. Under the terms of a $9.95 million original notional swap with an effective date of January 15, 2015, we will pay a fixed rate of 4.33% for a 10 year period. Under the terms of a $11.3 million original notional swap with an effective date of December 18, 2015, we will pay a fixed rate of 4.30% for a 10 year period.

A summary of our derivative financial instruments as of September 30, 2016 and December 31, 2015 follows:

	September 30, 2016			
		Derivative Fair Value		Net Ineffective
Dollars in thousands	Notional Amount	Asset	Liability	Hedge Gains/(Losses)
CASH FLOW HEDGES				
Pay-fixed/receive-variable interest rate swaps				
Short term borrowings	$110,000	$ —	$ 7,186	$ —
FAIR VALUE HEDGES				
Pay-fixed/receive-variable interest rate swaps				

Commercial real estate loans	$20,639	$—	$1,084	$ —

Dollars in thousands	December 31, 2015			
	Notional Amount	Derivative Fair Value		Net Ineffective Hedge Gains/(Losses)
		Asset	Liability	
CASH FLOW HEDGES				
Pay-fixed/receive-variable interest rate swaps				
Short term borrowings	$110,000	$—	$5,071	$ —
FAIR VALUE HEDGES				
Pay-fixed/receive-variable interest rate swaps				
Commercial real estate loans	$21,250	$94	$95	$ —

NOTE 16. EMPLOYEE STOCK OWNERSHIP PLAN ("ESOP")

On July 30, 2015, our ESOP purchased 225,000 shares of Summit Financial Group Inc. common stock in a privately negotiated transaction, at $10.80 per share for a total purchase price of $2,430,000. On July 21, 2015, our Board of Directors approved the company lending to our ESOP $2,250,000 to partially finance the purchase, and was used to purchase 208,333 unallocated shares.

In accordance with ASC 718, Compensation - Stock Compensation, this purchase of unallocated ESOP shares will be shown as a reduction of shareholders' equity, similar to a purchase of treasury stock. The loan receivable from the ESOP to the Company is not reported as an asset nor is the debt of the ESOP reported as a liability on the Company's Consolidated Balance Sheets. Cash dividends on allocated shares (those credited to ESOP participants' accounts) are recorded as a reduction of shareholders' equity and distributed directly to participants' accounts. Cash dividends on unallocated shares (those held by the ESOP not yet credited to participants' accounts) are used to pay a portion of the ESOPs debt service requirements.

Unallocated ESOP shares will be allocated to ESOP participants ratably as the ESOP's loan is repaid. When the shares are committed to be released and become available for allocation to plan participants, the then fair value of such shares will be charged to compensation expense. Unallocated shares owned by the Company’s ESOP are not considered to be outstanding for the purpose of computing earnings per share.

The ESOP shares as of September 30 as are follows:

ESOP Shares

	At September 30,	
	2016	2015
Allocated shares	406,371	363,347
Shares committed to be released	25,862	21,620
Unallocated shares	155,960	186,713
Total ESOP shares	588,193	571,680
Market value of unallocated shares (in thousands)	$2,988	$2,198

NOTE 17. ACQUISITIONS

On October 1, 2016, Summit Community Bank, Inc., a wholly-owned subsidiary of Summit, acquired Highland County Bankshares, Inc. ("HCB") and its subsidiary First and Citizens Bank, headquartered in Monterey, Virginia, for $21.8 million. HCB's assets and liabilities approximated $123 million and $107 million, respectively, at September

30, 2016.

The former First and Citizens offices will continue to operate under that name until close of business on Friday, December 2, 2016, and will commence operating under the name Summit Community Bank on Monday, December 5, 2016.

On June 1, 2016, we entered into a Definitive Merger Agreement between Summit Community Bank, Inc., a wholly-owned subsidiary of Summit, and First Century Bankshares, Inc. ("FCB"). Pursuant to the terms of the merger agreement, Summit Community Bank, Inc. will acquire all of the outstanding shares of common stock of FCB in exchange for cash in the amount of $22.50 per share or 1.2433 shares of Summit common stock. FCB shareholders will have a right to receive cash, Summit's common stock, or a combination of cash and Summit stock, subject to proration to result in approximately 35% cash and 65% stock consideration in the aggregate, subject to an adjustment if FCB’s adjusted shareholders’ equity as of the effective date of

the merger deviates materially from the target determined by the parties. FCB's assets approximated $413 million at September 30, 2016.
We have received all regulatory approvals, and anticipate the acquisition will close early 2017, subject to customary closing conditions, including approval of FCB's shareholders. Following the consummation of the merger, FCB’s wholly-owned subsidiary First Century Bank will be consolidated with Summit Community Bank.

Table of Contents

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 2015 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 increased by 6.46% for the first nine months in 2016 compared to the same period of 2015