

SUMMIT FINANCIAL GROUP INC
Form 10-Q
November 07, 2012

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

FORM 10 – Q

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

1934

ended September 30, 2012. For the quarterly period

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 (IRS Employer
incorporation or organization) Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

Yes No

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

Common Stock, \$2.50 par value
7,425,472 shares outstanding as of November 1, 2012

Summit Financial Group, Inc. and Subsidiaries
Table of Contents

	Page
PART I. FINANCIAL INFORMATION	
Item 1.	Financial Statements
	Consolidated balance sheets September 30, 2012 (unaudited), December 31, 2011, and September 30, 2011 (unaudited) 4
	Consolidated statements of income for the three and nine months ended September 30, 2012 and 2011 (unaudited) 5
	Consolidated statements of comprehensive income for the three and nine months ended September 30, 2012 and 2011 (unaudited) 6
	Consolidated statements of shareholders' equity for the nine months ended September 30, 2012 and 2011 (unaudited) 7
	Consolidated statements of cash flows for the nine months ended September 30, 2012 and 2011 (unaudited) 8-9
	Notes to consolidated financial statements (unaudited) 10-42
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations 43-58
Item 3.	Quantitative and Qualitative Disclosures about Market Risk 57
Item 4.	Controls and Procedures 58

Summit Financial Group, Inc. and Subsidiaries
Table of Contents

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings	59
Item 1A.	Risk Factors	59
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	None
Item 3.	Defaults upon Senior Securities	None
Item 4.	Mine Safety Disclosures	None
Item 5.	Other Information	None
Item 6.	Exhibits	59
SIGNATURES		60
EXHIBIT INDEX		61

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

Dollars in thousands	September 30, 2012 (unaudited)	December 31, 2011 (*)	September 30, 2011 (unaudited)
ASSETS			
Cash and due from banks	\$ 3,752	\$ 4,398	\$ 3,596
Interest bearing deposits with other banks	13,441	28,294	39,103
Securities available for sale	291,992	286,599	292,442
Other investments	16,100	19,146	20,028
Loans held for sale, net	213	-	294
Loans, net	940,933	965,516	964,349
Property held for sale	56,033	63,938	62,738
Premises and equipment, net	21,264	22,084	22,334
Accrued interest receivable	5,352	5,784	5,395
Intangible assets	8,387	8,651	8,739
Cash surrender value of life insurance policies	30,065	29,284	29,034
Other assets	16,554	16,427	16,532
Total assets	\$ 1,404,086	\$ 1,450,121	\$ 1,464,584
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	\$ 96,764	\$ 88,655	\$ 85,406
Interest bearing	930,543	927,845	961,903
Total deposits	1,027,307	1,016,500	1,047,309
Short-term borrowings	20,957	15,956	955
Long-term borrowings	203,744	270,254	272,031
Subordinated debentures	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	8,361	8,456	8,976
Total liabilities	1,296,758	1,347,555	1,365,660
Commitments and Contingencies			
Shareholders' Equity			
Preferred stock and related surplus - authorized 250,000 shares; Series 2009, 8% Non-cumulative convertible preferred stock, par value \$1.00; issued 3,710 shares	3,519	3,519	3,519

Series 2011, 8% Non-cumulative convertible preferred stock, par value \$1.00; issued September 2012 and December 2011 - 12,000 shares;	5,807	5,807	3,562
September 2011 - 7,399 shares			
Common stock and related surplus - authorized 20,000,000 shares; \$2.50 par value; issued and outstanding 7,425,472 shares	24,520	24,518	24,517
Retained earnings	67,929	64,904	63,572
Accumulated other comprehensive income	5,553	3,818	3,754
Total shareholders' equity	107,328	102,566	98,924
Total liabilities and shareholders' equity	\$ 1,404,086	\$ 1,450,121	\$ 1,464,584

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

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

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

Dollars in thousands, except per share amounts	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2012	2011	2012	2011
Interest income				
Interest and fees on loans				
Taxable	\$ 13,572	\$ 14,656	\$ 41,812	\$ 44,623
Tax-exempt	76	61	243	191
Interest and dividends on securities				
Taxable	1,340	2,105	4,593	7,288
Tax-exempt	594	816	1,986	1,800
Interest on interest bearing deposits with other banks				
	7	14	30	59
Total interest income	15,589	17,652	48,664	53,961
Interest expense				
Interest on deposits	3,067	4,561	10,140	13,971
Interest on short-term borrowings	8	1	25	2
Interest on long-term borrowings and subordinated debentures				
	2,579	3,169	8,575	9,805
Total interest expense	5,654	7,731	18,740	23,778
Net interest income	9,935	9,921	29,924	30,183
Provision for loan losses	2,000	2,001	6,002	8,001
Net interest income after provision for loan losses	7,935	7,920	23,922	22,182
Other income				
Insurance commissions	1,052	1,073	3,352	3,458
Service fees related to deposit accounts	1,074	1,078	3,163	3,024
Realized securities gains	760	1,517	2,245	3,463
Gain (loss) on sales of assets	16	130	(583)	277
Write-downs of foreclosed properties	(2,571)	(1,637)	(6,114)	(5,770)
Other	514	510	1,649	1,354
Total other-than-temporary impairment loss on securities	(233)	(1,684)	(1,115)	(4,815)
Portion of loss recognized in other comprehensive income	194	1,200	740	2,570
Net impairment loss recognized in earnings	(39)	(484)	(375)	(2,245)
Total other income	806	2,187	3,337	3,561
Other expense				
Salaries, commissions, and employee benefits				
	3,940	3,959	11,733	11,987
Net occupancy expense	476	473	1,445	1,463
Equipment expense	576	589	1,773	1,750
Professional fees	250	265	781	654
Amortization of intangibles	88	88	263	263
FDIC premiums	510	580	1,532	1,859
Foreclosed properties expense	395	389	1,017	1,235

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

Other	1,237	1,230	3,762	3,240
Total other expense	7,472	7,573	22,306	22,451
Income before income taxes	1,269	2,534	4,953	3,292
Income tax expense	272	598	1,345	698
Net Income	997	1,936	3,608	2,594
Dividends on preferred shares	194	74	583	223
Net Income applicable to common shares	\$ 803	\$ 1,862	\$ 3,025	\$ 2,371
Basic earnings per common share	\$ 0.11	\$ 0.25	\$ 0.41	\$ 0.32
Diluted earnings per common share	\$ 0.10	\$ 0.24	\$ 0.38	\$ 0.32

See Notes to Consolidated Financial Statements

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

Dollars in thousands	For the Three Months Ended	
	September 30,	
	2012	2011
Net income	\$ 997	\$ 1,936
Other comprehensive income (loss):		
Non-credit related other-than-temporary impairment on available for sale debt securities - 2012 - \$194, net of deferred taxes of \$74; 2011 - \$1,200, net of deferred taxes of \$456	(120)	(744)
Net unrealized gain on available for sale debt securities of: 2012 - \$1,513 net of deferred taxes of \$575 and reclassification adjustment for net realized gains included in net income of \$760; 2011 - \$3,847, net of deferred taxes of \$1,462 and reclassification adjustment for net realized gains included in net income of \$1,517	938	2,385
Total comprehensive income	\$ 1,815	\$ 3,577

Dollars in thousands	For the Nine Months Ended	
	September 30,	
	2012	2011
Net income	\$ 3,608	\$ 2,594
Other comprehensive income (loss):		
Non-credit related other-than-temporary impairment on available for sale debt securities - 2012 - \$740, net of deferred taxes of \$281; 2011 - \$2,570, net of deferred taxes of \$976	(459)	(1,594)

Net unrealized gain on available for sale debt securities of:			
2012 - \$3,539 net of deferred taxes of \$1,345 and reclassification adjustment			
for net realized gains included in net income of \$2,245; 2011 - \$7,669, net of			
deferred taxes of \$2,914 and reclassification adjustment for net realized			
gains included in net income of			
\$3,463		2,194	4,755
Total comprehensive income	\$	5,343	\$ 5,755

See Notes to Consolidated Financial Statement

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

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

	Series 2009 Preferred Stock and Related Surplus	Series 2011 Preferred Stock and Related Surplus	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Compre- hensive Income	Total Share- holders' Equity
Dollars in thousands, except per share amounts						
Balance, December 31, 2011	\$ 3,519	\$ 5,807	\$ 24,518	\$ 64,904	\$ 3,818	\$ 102,566
Nine Months Ended September 30, 2012						
Comprehensive income:						
Net income	-	-	-	3,608	-	3,608
Other comprehensive income					1,735	1,735
Total comprehensive income						5,343
Stock compensation expense	-	-	2	-	-	2
Series 2009 Preferred Stock cash dividends declared (\$40.00 per share)	-	-	-	(223)	-	(223)
Series 2011 Preferred Stock cash dividends declared (\$40.00 per share)	-	-	-	(360)	-	(360)
Balance, September 30, 2012	\$ 3,519	\$ 5,807	\$ 24,520	\$ 67,929	\$ 5,553	\$ 107,328
Balance, December 31, 2010	\$ 3,519	\$ -	\$ 24,508	\$ 61,201	\$ 593	\$ 89,821
Nine Months Ended September 30, 2011						
Comprehensive income:						
Net income	-	-	-	2,594	-	2,594
Other comprehensive income					3,161	3,161
Total comprehensive income						5,755
Stock compensation expense	-	-	9	-	-	9
Subscription of 7,399 shares Series 2011 Preferred Stock	-	3,562	-	-	-	3,562
Series 2009 Preferred Stock cash dividends declared (\$40.00 per share)	-	-	-	(223)	-	(223)
Balance, September 30, 2011	\$ 3,519	\$ 3,562	\$ 24,517	\$ 63,572	\$ 3,754	\$ 98,924

See Notes to Consolidated Financial Statements

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

Dollars in thousands	Nine Months Ended	
	September 30, 2012	September 30, 2011
Cash Flows from Operating Activities		
Net income	\$ 3,608	\$ 2,594
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	989	1,056
Provision for loan losses	6,002	8,001
Stock compensation expense	2	9
Deferred income tax (benefit)	(1,172)	(2,362)
Loans originated for sale	(5,463)	(6,978)
Proceeds from loans sold	5,251	7,027
Securities (gains)	(2,245)	(3,463)
Other-than-temporary impairment of securities	375	2,245
(Gain) loss on disposal of assets	583	(277)
Write-downs of foreclosed properties	6,114	5,770
Amortization of securities premiums (accretion of discounts), net	3,181	1,455
Amortization of goodwill and purchase accounting adjustments, net	272	272
Decrease in accrued interest receivable	431	483
(Increase) in cash surrender value of bank owned life insurance	(781)	(576)
(Increase) in other assets	(972)	(685)
(Decrease) in other liabilities	(140)	(343)
Net cash provided by operating activities	16,035	14,228
Cash Flows from Investing Activities		
Proceeds from interest bearing deposits		
with other banks	14,853	6,592
Proceeds from maturities and calls of securities available for sale	4,056	6,985
	64,567	97,826

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

Proceeds from sales of securities available for sale		
Principal payments received on securities available for sale	47,584	43,385
Purchases of securities available for sale	(120,114)	(170,045)
Proceeds from maturities and calls of other investments	-	5,999
Redemption of Federal Home Loan Bank Stock	3,048	2,914
Net principal payments received on loans	13,736	13,680
Purchases of premises and equipment	(170)	(298)
Proceeds from sales of other repossessed assets & property held for sale	6,998	11,674
Purchase of life insurance contracts	-	(15,000)
Net cash provided by (used in) investing activities	34,558	3,712
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and savings accounts	15,662	55,328
Net (decrease) in time deposits	(4,856)	(44,958)
Net increase (decrease) in short-term borrowings	5,002	(627)
Proceeds from long-term borrowings	-	842
Repayment of long-term borrowings	(66,510)	(32,920)
Dividends paid on preferred stock	(537)	(223)
Proceeds from issuance of preferred stock	-	3,562
Net cash provided by (used in) financing activities	(51,239)	(18,996)
(Decrease) in cash and due from banks	(646)	(1,056)
Cash and due from banks:		
Beginning	4,398	4,652
Ending	\$ 3,752	\$ 3,596

(Continued)

See Notes to Consolidated Financial Statements

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

Dollars in thousands	Nine Months Ended	
	September 30, 2012	September 30, 2011
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	\$ 19,335	\$ 24,120
Income taxes	\$ 1,834	\$ 1,925
Supplemental Schedule of Noncash Investing and Financing Activities		
Other assets acquired in settlement of loans	\$ 5,266	\$ 9,289

See Notes to Consolidated
 Financial Statements

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

NOTE 1. BASIS OF PRESENTATION

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

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates.

The results of operations for the quarter ended September 30, 2012 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2011 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2011 and September 30, 2011, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

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

ASU 2011-04, Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs amends Topic 820, Fair Value Measurements and Disclosures, to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 was effective January 1, 2012 and did not have a significant impact on our financial statements.

ASU 2011-05, Comprehensive Income (Topic 220) - Presentation of Comprehensive Income amends Topic 220, Comprehensive Income, to require that all nonowner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. ASU 2011-05 was effective January 1, 2012 and did not have a significant impact on our financial statements.

ASU 2011-08, Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment, amends Topic 350, Intangibles – Goodwill and Other, permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-than-likely-than-not threshold is defined as having a likelihood of more than 50 percent. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of impairment loss, if any. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and did not have a significant impact on our financial statements.

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

ASU 2011-11, Disclosures about Offsetting Assets and Liabilities (Topic 210), requires an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning January 1, 2013, and is not expected to have a significant impact on our financial statements.

ASU 2011-12, Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05, defers changes in ASU 2011-05 that relate to the presentation of reclassification adjustments to allow the FASB time to redeliberate whether to require presentation of such adjustments on the face of the financial statements to show the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. ASU 2011-12 allows entities to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12. ASU 2011-12 became effective for us on January 1, 2012 and did not have a significant impact on our financial statements.

NOTE 3. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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

Available-for-Sale Securities: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss

assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities.

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

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

Loans: We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the 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 fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2012, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with ASC Topic 310, impaired loans where an allowance is established based on the fair value of collateral requires classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When a current appraised value is not available and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

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

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

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

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

Dollars in thousands	Balance at September 30, 2012	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	\$ 26,862	\$ -	\$ 26,862	\$ -
Mortgage backed securities:				
Government sponsored agencies	153,521	-	153,521	-
Nongovernment sponsored entities	21,621	-	21,621	-
State and political subdivisions	10,177	-	10,177	-
Corporate debt securities	1,910	-	1,910	-
Other equity securities	77	-	77	-
Tax-exempt state and political subdivisions	74,966	-	74,966	-
Tax-exempt mortgage-backed securities	2,858	-	2,858	-
Total available for sale securities	\$ 291,992	\$ -	\$ 291,992	\$ -

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

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended September 30, 2012.

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

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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

Dollars in thousands	Total at September 30, 2012	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 213	\$ -	\$ 213	\$ -
Impaired loans				
Commercial	\$ 12,326	\$ -	\$ -	\$ 12,326
Commercial real estate	27,287	-	18,147	9,140
Construction and development	28,375	-	26,526	1,849
Residential real estate	25,992	-	23,031	2,961
Consumer	38	-	-	38
Total impaired loans	\$ 94,018	\$ -	\$ 67,704	\$ 26,314
OREO				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial real estate	11,802	-	11,802	-
Construction and development	41,452	-	40,777	675
Residential real estate	2,779	-	2,779	-
Consumer	-	-	-	-
Total OREO	\$ 56,033	\$ -	\$ 55,358	\$ 675

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

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

Commercial real estate	15,721	-	15,721	-
Construction and development	44,978	-	44,303	675
Residential real estate	3,239	-	3,239	-
Consumer	-	-	-	-
Total OREO	\$ 63,938	\$ -	\$ 63,263	\$ 675

Impaired loans, which are measured for impairment primarily using the fair value of the collateral for collateral-dependent loans, had a carrying amount at September 30, 2012 of \$101,327,000, with a valuation allowance of \$7,309,000, resulting in additional specific reserves of \$2,275,000 for the nine months ended September 30, 2012.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Dollars in thousands	September 30, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and due from banks	\$ 3,752	\$ 3,752	\$ 4,398	\$ 4,398
Interest bearing deposits with				
other banks	13,441	13,441	28,294	28,294
Securities available for sale	291,992	291,992	286,599	286,599
Other investments	16,100	16,100	19,146	19,146
Loans held for sale, net	213	213	-	-
Loans, net	940,933	975,347	965,516	977,782
Accrued interest receivable	5,352	5,352	5,784	5,784
	\$ 1,271,783	\$ 1,306,197	\$ 1,309,737	\$ 1,322,003
Financial liabilities				
Deposits	\$ 1,027,307	\$ 1,065,036	\$ 1,016,500	\$ 1,054,093
Short-term borrowings	20,957	20,957	15,956	15,956
Long-term borrowings	203,744	222,022	270,254	291,099
Subordinated debentures	16,800	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589	19,589
Accrued interest payable	1,963	1,963	2,558	2,558
	\$ 1,290,360	\$ 1,346,367	\$ 1,341,657	\$ 1,400,095

NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

Dollars in thousands, except per share amounts	For Three Months Ended September 30, 2012			2011		
	Income	Common Shares	Per Share	Income	Common Shares	Per Share
Net income	\$ 997	(Numerator)	(Denominator) Share	\$ 1,936	(Numerator)	(Denominator) Share
Less preferred stock dividends	(194)			(74)		

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

Basic EPS	\$ 803	7,425,472	\$ 0.11	\$ 1,862	7,425,472	\$ 0.25
Effect of dilutive securities:						
Stock options		1,261			-	
Series 2009 convertible preferred stock	74	674,545		74	674,545	
Series 2011 convertible preferred stock	120	1,500,000		-	10,053	
Diluted EPS	\$ 997	9,601,278	\$ 0.10	\$ 1,936	8,110,070	\$ 0.24

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

Dollars in thousands, except per share amounts	For the Nine Months Ended September 30,					
	2012	Common			2011	
	Income	Shares	Per Share	Income	Shares	Per Share
	(Numerator)	(Denominator)	Share	(Numerator)	(Denominator)	Share
Net income	\$ 3,608			\$ 2,594		
Less preferred stock dividends	(583)			(223)		
Basic EPS	\$ 3,025	7,425,472	\$ 0.41	\$ 2,371	7,425,472	\$ 0.32
Effect of dilutive securities:						
Stock options		1,081		-		
Series 2009 convertible preferred stock	223	674,545		-	-	
Series 2011 convertible preferred stock	360	1,500,000		-	3,388	
Diluted EPS	\$ 3,608	9,601,098	\$ 0.38	\$ 2,371	7,428,860	\$ 0.32

Stock option grants and the convertible preferred shares are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options at September 30, 2012 and 2011 totaled 289,380 shares and 312,180 shares, respectively. Our anti-dilutive convertible preferred shares totaled 674,545 for the nine months ended September 30, 2011.

NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at September 30, 2012, December 31, 2011, and September 30, 2011 are summarized as follows:

Dollars in thousands Available for Sale	Amortized Cost	September 30, 2012		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Taxable debt securities:				
U. S. Government agencies and corporations				
	\$ 25,857	\$ 1,009	\$ 4	\$ 26,862

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

Residential mortgage-backed securities:				
Government-sponsored agencies	150,233	3,741	453	153,521
Nongovernment-sponsored agencies	21,199	712	290	21,621
State and political subdivisions	10,176	57	56	10,177
Corporate debt securities	1,955	29	74	1,910
Total taxable debt securities	209,420	5,548	877	214,091
Tax-exempt debt securities:				
State and political subdivisions	70,678	4,358	70	74,966
Residential mortgage-backed securities:				
Government-sponsored agencies	2,858	-	-	2,858
Total tax-exempt debt securities	73,536	4,358	70	77,824
Equity securities	77	-	-	77
Total available for sale securities	\$ 283,033	\$ 9,906	\$ 947	\$ 291,992

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

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

Dollars in thousands	Amortized Cost	September 30, 2011		Estimated Fair Value
		Gains	Losses	
Available for Sale				
Taxable debt securities:				
U. S. Government agencies and corporations	\$ 8,351	\$ 494	\$ -	\$ 8,845
Residential mortgage-backed securities:				
Government-sponsored agencies	153,271	3,974	521	156,724
Nongovernment-sponsored agencies	40,946	1,072	1,738	40,280
State and political subdivisions	4,561	23	5	4,579
Corporate debt securities	999	-	152	847
Total taxable debt securities	208,128	5,563	2,416	211,275
Tax-exempt debt securities:				
State and political subdivisions	78,179	3,102	191	81,090
Total tax-exempt debt securities	78,179	3,102	191	81,090
Equity securities	77	-	-	77
Total available for sale securities	\$ 286,384	\$ 8,665	\$ 2,607	\$ 292,442

The maturities, amortized cost and estimated fair values of securities at September 30, 2012, are summarized as follows:

Dollars in thousands	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 77,442	\$ 78,853
Due from one to five years	92,630	94,923
Due from five to ten years	13,905	14,539
Due after ten years	98,979	103,600
Equity securities	77	77
	\$ 283,033	\$ 291,992

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

The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the nine months ended September 30, 2012 are as follows:

Dollars in thousands	Sales	Calls and Maturities	Principal Payments	Gains	Losses
Securities available for sale	\$ 64,567	\$ 4,056	\$ 47,584	\$ 3,085	\$ 840

During the three and nine months ended September 30, 2012 and 2011, we recorded other-than-temporary impairment losses on residential mortgage-backed nongovernment sponsored entity securities as follows:

In thousands	Three Months Ended		Nine Months Ended	
	2012	2011	2012	2011
Total other-than-temporary impairment losses	\$ (233)	\$ (1,684)	\$ (1,115)	\$ (4,815)
Portion of loss recognized in other comprehensive income	194	1,200	740	2,570
Net impairment losses recognized in earnings	\$ (39)	\$ (484)	\$ (375)	\$ (2,245)

Activity related to the credit component recognized on debt securities available for sale for which a portion of other-than-temporary impairment was recognized in other comprehensive income for the three and nine months ended September 30, 2012 is as follows:

In thousands	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012
Beginning Balance	\$ (5,900)	\$ (6,355)
Additions for the credit component on debt securities in which other-than-temporary impairment was not previously recognized	(39)	(375)

Securities sold during the period	-	791
Ending Balance	\$ (5,939)	\$ (5,939)

At September 30, 2012, our debt securities with other-than-temporary impairment in which only the amount of loss related to credit was recognized in earnings consisted solely of residential mortgage-backed securities issued by nongovernment-sponsored entities. We utilize third party vendors to estimate the portion of loss attributable to credit using a discounted cash flow models. The vendors estimate cash flows of the underlying collateral of each mortgage-backed security using models that incorporate their best estimates of current key assumptions, such as default rates, loss severity and prepayment rates. Assumptions utilized vary widely from security to security, and are influenced by such factors as underlying loan interest rates, geographical location of underlying borrowers, collateral type and other borrower characteristics. Specific such assumptions utilized by our vendors in their valuation of our other-than-temporarily impaired residential mortgage-backed securities issued by nongovernment-sponsored entities were as follows at September 30, 2012:

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

	Weighted Average		Range Minimum		Range Maximum	
Constant voluntary prepayment rates	12.2 %		10.1 %		14.1 %	
Constant default rates	4.9 %		4.6 %		5.2 %	
Loss severities	45.5 %		40.0 %		52.0 %	

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

Provided below is a summary of securities available for sale which were in an unrealized loss position at September 30, 2012 and December 31, 2011, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

Dollars in thousands	Less than 12 months		September 30, 2012 12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies and corporations	\$ 1,413	\$ (4)	\$ -	\$ -	\$ 1,413	\$ (4)
Residential mortgage-backed securities:						
Government-sponsored agencies	35,490	(395)	7,256	(58)	42,746	(453)
Nongovernment-sponsored entities	1	(4)	3,013	(67)	3,014	(71)
State and political subdivisions	3,370	(52)	386	(4)	3,756	(56)
Corporate debt securities	-	-	925	(74)	925	(74)
Tax-exempt debt securities						
State and political subdivisions	8,192	(70)	-	-	8,192	(70)
Total temporarily impaired securities	48,466	(525)	11,580	(203)	60,046	(728)
Other-than-temporarily impaired securities						
Taxable debt securities						
Residential mortgage-backed securities:						

Nongovernment-sponsored entities	-	-	703	(219)	703	(219)
Total other-than-temporarily impaired securities	-	-	703	(219)	703	(219)
Total	\$ 48,466	\$ (525)	\$ 12,283	\$ (422)	\$ 60,749	\$ (947)

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

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

We held 59 available for sale securities, including debt securities with other-than-temporary impairment in which a portion of the impairment remains in other comprehensive income, having an unrealized loss at September 30, 2012. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no additional other-than-temporary impairment charge to earnings is warranted at this time.

At September 30, 2012, we had \$290,000 in total unrealized losses related to residential mortgage-backed securities issued by nongovernment sponsored entities. We monitor the performance of the mortgages underlying these bonds. Although there has been some deterioration in their collateral performance, we primarily hold the senior tranches of each issue which provides protection against defaults. We attribute the unrealized loss on these

mortgage-backed securities held largely to the current absence of liquidity in the markets for such securities. The mortgages in these asset pools have been made to borrowers with strong credit history and significant equity invested in their homes. Nonetheless, further weakening of economic fundamentals coupled with significant increases in unemployment and substantial deterioration in the value of high end residential properties could extend distress to this borrower population. This could increase default rates and put additional pressure on property values. Should these conditions occur, the value of these securities could decline further and result in the recognition of additional other-than-temporary impairment charges recognized in earnings.

NOTE 6. LOANS

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

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

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

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

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

Loans are summarized as follows:

	September 30, 2012	December 31, 2011	September 30, 2011
Dollars in thousands			
Commercial	\$ 88,997	\$ 99,024	\$ 90,422
Commercial real estate			
Owner-occupied	150,090	158,754	171,192
Non-owner occupied	279,132	270,226	253,538
Construction and development			
Land and land development	82,857	93,035	94,023
Construction	2,087	2,936	9,445
Residential real estate			
Non-jumbo	215,584	221,733	224,499
Jumbo	62,748	61,535	62,255
Home equity	53,455	50,898	51,025
Consumer	21,290	22,325	22,988
Other	2,513	2,762	2,911
Total loans, net of unearned fees	958,753	983,228	982,298
Less allowance for loan losses	17,820	17,712	17,949
Loans, net	\$ 940,933	\$ 965,516	\$ 964,349

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

The following table presents the contractual aging of the recorded investment in past due loans by class as of September 30, 2012 and 2011 and December 31, 2011.

At September 30, 2012						Recorded Investment > 90 days and Accruing
Past Due			Total	Current		
Dollars in thousands	30-59 days	60-89 days				> 90 days
Commercial	\$ 273	\$ 634	\$ 1,594	\$ 2,501	\$ 86,496	\$ -
Commercial real estate						
Owner-occupied	216	581	400	1,197	148,893	-
Non-owner occupied	513	-	1,882	2,395	276,737	-
Construction and development						
Land and land development	17	39	13,412	13,468	69,389	-
Construction	50	-	153	203	1,884	-
Residential mortgage						
Non-jumbo	2,681	2,029	2,544	7,254	208,330	-
Jumbo	-	-	15,273	15,273	47,475	-
Home equity	280	5	149	434	53,021	-
Consumer	319	36	46	401	20,889	-
Other	-	-	-	-	2,513	-
Total	\$ 4,349	\$ 3,324	\$ 35,453	\$ 43,126	\$ 915,627	\$ -

At December 31, 2011						Recorded Investment > 90 days and Accruing
Past Due			Total	Current		
Dollars in thousands	30-59 days	60-89 days				> 90 days
Commercial	\$ 904	\$ 324	\$ 2,544	\$ 3,772	\$ 95,252	\$ -
Commercial real estate						
Owner-occupied	4,241	197	664	5,102	153,652	-
Non-owner occupied	1,566	1,752	1,705	5,023	265,203	-
Construction and development						
Land and land development	1,539	116	16,392	18,047	74,988	344
Construction	106	-	979	1,085	1,851	-

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

Residential mortgage

Non-jumbo	4,730	1,624	2,336	8,690	213,043	-
Jumbo	699	-	13,965	14,664	46,871	-
Home equity	-	223	91	314	50,584	-
Consumer	381	144	85	610	21,715	-
Other	-	-	-	-	2,762	-
Total	\$ 14,166	\$ 4,380	\$ 38,761	\$ 57,307	\$ 925,921	\$ 344

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

At September 30, 2011

Dollars in thousands	Past Due			Total	Current	Recorded Investment > 90 days and Accruing
	30-59 days	60-89 days	> 90 days			
Commercial	\$ 194	\$ 178	\$ 2,606	\$ 2,978	\$ 87,444	\$ -
Commercial real estate						
Owner-occupied	510	-	1,403	1,913	169,279	-
Non-owner occupied	1,926	667	1,308	3,901	249,637	-
Construction and development						
Land and land development	814	438	4,635	5,887	88,136	-
Construction	-	-	152	152	9,293	-
Residential mortgage						
Non-jumbo	3,973	835	3,493	8,301	216,198	-
Jumbo	-	-	1,345	1,345	60,910	-
Home equity	28	132	120	280	50,745	-
Consumer	178	141	77	396	22,592	-
Other	-	-	-	-	2,911	-
Total	\$ 7,623	\$ 2,391	\$ 15,139	\$ 25,153	\$ 957,145	\$ -

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at September 30, 2012, December 31, 2011 and September 30, 2011.

Dollars in thousands	9/30/2012	12/31/2011	9/30/2011
Commercial	\$ 5,343	\$ 3,260	\$ 3,473
Commercial real estate			
Owner-occupied	921	2,815	3,451
Non-owner occupied	1,882	4,348	4,948
Construction and development			
Land & land development	16,558	22,362	17,354
Construction	203	979	152
Residential mortgage			
Non-jumbo	3,122	3,683	3,949
Jumbo	15,272	13,966	2,273
Home equity	415	538	595
Consumer	87	145	87
Other	-	-	-
Total	\$ 43,803	\$ 52,096	\$ 36,282

Impaired loans: Impaired loans include the following:

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

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

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

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.

Method Used to Measure Impairment of Impaired Loans

Dollars in thousands

Loan Category	9/30/2012	12/31/2011	9/30/2011	Method used to measure impairment
Commerical	\$ 12,411	\$ 2,969	\$ 3,043	Fair value of collateral
	-	-	-	Discounted cash flow
Commerical real estate				
Owner-occupied	13,248	9,698	10,613	Fair value of collateral
	2,698	2,580	2,591	Discounted cash flow
Non-owner occupied	12,057	9,790	11,397	Fair value of collateral
	-	-	1,791	Discounted cash flow
Construction and development				
Land & land development	30,482	29,862	26,360	Fair value of collateral
	656	-	1,525	Discounted cash flow
Construction	-	735	-	Fair value of collateral
Residential mortgage				
Non-jumbo	5,461	4,488	5,157	Fair value of collateral
	959	372	1,179	Discounted cash flow
Jumbo	23,094	18,147	14,894	Fair value of collateral

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

Home equity	219	407	409	Fair value of collateral
Consumer	42	8	-	Fair value of collateral
Total	\$ 101,327	\$ 79,056	\$ 78,959	

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

The following tables present loans individually evaluated for impairment at September 30, 2012, December 31, 2011 and September 30, 2011.

Dollars in thousands	September 30, 2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 12,059	\$ 12,075	\$ -	\$ 3,148	\$ 54
Commercial real estate					
Owner-occupied	11,370	11,373	-	8,058	346
Non-owner occupied	8,537	8,540	-	6,349	304
Construction and development					
Land & land development	15,624	15,624	-	14,060	524
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	3,987	3,996	-	3,545	135
Jumbo	8,902	8,905	-	6,497	257
Home equity	191	191	-	192	12
Consumer	39	38	-	30	1
Total without a related allowance	\$ 60,709	\$ 60,742	\$ -	\$ 41,879	\$ 1,633
With a related allowance					
Commercial	\$ 336	\$ 336	\$ 86	\$ 299	\$ 6
Commercial real estate					
Owner-occupied	4,573	4,573	241	4,409	209
Non-owner occupied	3,516	3,517	475	3,361	115
Construction and development					
Land & land development	15,514	15,514	2,762	15,026	182
Construction	-	-	-	-	-

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

Residential real estate					
Non-jumbo	2,422	2,424	502	1,787	101
Jumbo	14,183	14,189	3,211	13,193	32
Home equity	28	28	28	29	-
Consumer	4	4	4	1	-
Total with a related allowance					
	\$ 40,576	\$ 40,585	\$ 7,309	\$ 38,105	\$ 645
Total					
Commercial	\$ 71,529	\$ 71,552	\$ 3,564	\$ 54,710	\$ 1,740
Residential real estate					
	29,713	29,733	3,741	25,243	537
Consumer	43	42	4	31	1
Total	\$ 101,285	\$ 101,327	\$ 7,309	\$ 79,984	\$ 2,278

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

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

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

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

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

Dollars in thousands	September 30, 2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 2,739	\$ 2,741	\$ -	\$ 1,060	\$ 12
Commercial real estate					
Owner-occupied	9,932	9,948	-	7,298	160
Non-owner occupied	8,958	8,961	-	3,489	104
Construction and development					
Land & land development	18,266	18,266	-	15,915	257
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	3,976	3,983	-	4,502	123
Jumbo	12,621	12,621	-	12,618	687
Home equity	195	194	-	173	8
Total without a related allowance	\$ 56,687	\$ 56,714	\$ -	\$ 45,055	\$ 1,351
With a related allowance					
Commercial	\$ 302	\$ 302	\$ 103	\$ 73	\$ -
Commercial real estate					
Owner-occupied	3,255	3,256	465	3,703	107
Non-owner occupied	4,227	4,227	493	3,073	65
Construction and development					
Land & land development	9,619	9,619	1,933	3,774	77
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	2,351	2,353	823	1,621	39
Jumbo	2,270	2,273	513	1,666	-
Home equity	215	215	166	95	2

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

Consumer	-	-	-	-	-
Total with a related allowance	\$ 22,239	\$ 22,245	\$ 4,496	\$ 14,005	\$ 290
Total					
Commercial	\$ 57,298	\$ 57,320	\$ 2,994	\$ 38,385	\$ 782
Consumer	-	-	-	-	-
Residential real estate	21,628	21,639	1,502	20,675	859
Total	\$ 78,926	\$ 78,959	\$ 4,496	\$ 59,060	\$ 1,641

A modification of a loan is considered a troubled debt restructuring (“TDR”) when a borrower is experiencing financial difficulty and the modification constitutes a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of both. A loan continues to qualify as a TDR until a consistent payment history or change in the borrower’s financial condition has been evidenced, generally no less than twelve months. Included in impaired loans are TDRs of \$55,242,000 and \$47,770,000 at September 30, 2012 and December 31, 2011, respectively, with no commitments to lend additional funds under these restructurings at either balance sheet date.

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

The following table presents by class the TDRs that were restructured during the three and nine months ended September 30, 2012. Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes.

dollars in thousands	For the Three Months Ended September 30, 2012			For the Nine Months Ended September 30, 2012		
	Number of Modifications	Pre-modification	Post-modification	Number of Modifications	Pre-modification	Post-modification
		Recorded Investment	Recorded Investment		Recorded Investment	Recorded Investment
Commercial	-	\$ -	\$ -	3	\$ 1,109	\$ 1,117
Commercial real estate						
Owner-occupied	-	-	-	-	-	-
Non-owner occupied	1	1,929	1,929	3	4,063	3,685
Construction and development						
Land & land development	2	1,927	1,927	3	3,715	2,927
Construction	-	-	-	-	-	-
Residential real estate						
Non-jumbo	3	688	688	7	1,245	1,256
Jumbo	-	-	-	3	2,301	2,701
Home equity	-	-	-	-	-	-
Consumer	-	-	-	2	42	42
Total	6	\$ 4,544	\$ 4,544	21	\$ 12,475	\$ 11,728

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

dollars in thousands	For the Three Months Ended September 30, 2012		For the Nine Months Ended September 30, 2012	
	Number of Defaults	Recorded Investment at Default Date	Number of Defaults	Recorded Investment at Default Date
	Commercial	-	\$ -	-
Commercial real estate				
Owner-occupied	1	581	1	580
Non-owner occupied	-	-	-	-

Construction and development				
Land & land development	-	-	-	-
Construction	-	-	-	-
Residential real estate				
Non-jumbo	2	233	2	233
Jumbo	2	4,218	3	4,727
Home equity	-	-	-	-
Consumer	1	34	1	36
Total	6	\$ 5,066	7	\$ 5,576

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

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

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.

Loan Risk Profile by Internal Risk Rating

	Construction and Development				Commercial Real Estate					
	Land and land development		Construction		Commercial		Owner Occupied		Non-Owner Occupied	
Dollars in thousands	9/30/2012	12/31/2011	9/30/2012	12/31/2011	9/30/2012	12/31/2011	9/30/2012	12/31/2011	9/30/2012	12/31/2011
Pass	\$ 44,279	\$ 47,521	\$ 1,934	\$ 1,886	\$ 75,249	\$ 84,225	\$ 149,266	\$ 143,845	\$ 262,349	\$ 253,319
OLEM (Special Mention)	9,137	18,615	-	-	986	6,889	824	5,474	11,719	10,421
Substandard	29,441	26,899	153	1,049	12,762	7,910	-	9,435	5,064	6,486
Doubtful	-	-	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-	-	-
Total	\$ 82,857	\$ 93,035	\$ 2,087	\$ 2,935	\$ 88,997	\$ 99,024	\$ 150,090	\$ 158,754	\$ 279,132	\$ 270,226

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

Dollars in thousands	9/30/2012	Performing 12/31/2011	9/30/2011	9/30/2012	Nonperforming 12/31/2011	9/30/2011
----------------------	-----------	--------------------------	-----------	-----------	-----------------------------	-----------

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

Residential real
estate

Non-jumbo	\$ 212,529	\$ 218,050	\$ 220,550	\$ 3,055	\$ 3,683	\$ 3,949
Jumbo	47,476	47,570	59,982	15,272	13,965	2,273
Home Equity	53,040	50,360	50,430	415	538	595
Consumer	21,202	22,180	22,901	88	145	87
Other	2,513	2,762	2,911	-	-	-
Total	\$ 336,760	\$ 340,922	\$ 356,774	\$ 18,830	\$ 18,331	\$ 6,904

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

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

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

Dollars in thousands	Nine Months Ended		Year Ended
	2012	September 30, 2011	December 31, 2011
Balance, beginning of year	\$ 17,712	\$ 17,224	\$ 17,224
Losses:			
Commercial	355	500	506
Commercial real estate			
Owner occupied	636	501	508
Non-owner occupied	436	76	78
Construction and development			
Land and land development	2,319	2,446	3,568
Construction	367	-	-
Residential real estate			
Non-jumbo	1,257	2,524	3,178
Jumbo	737	1,098	1,511
Home equity	5	234	346
Consumer	91	113	162
Other	69	82	86
Total	6,272	7,574	9,943
Recoveries:			
Commercial	7	34	35
Commercial real estate			
Owner occupied	24	37	37
	20	31	55

Non-owner occupied			
Construction and development			
Land and land development	16	8	43
Construction	-	-	-
Real estate - mortgage			
Non-jumbo	51	46	83
Jumbo	85	6	14
Home equity	60	1	1
Consumer	53	72	112
Other	62	63	51
Total	378	298	431
Net losses	5,894	7,276	9,512
Provision for loan losses	6,002	8,001	10,000
Balance, end of year	\$ 17,820	\$ 17,949	\$ 17,712

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

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

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

Dollars in thousands	Construction & Land Development		Commercial Real Estate	Commercial Real Estate		Residential Real Estate			Other	Total	
	Land & Land Development	Construction		Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity			
Allowance for loan losses											
Beginning balance	\$7,262	\$120	\$771	\$1,336	\$3,283	\$2,586	\$1,331	\$831	\$160	\$32	\$17,712
Charge-offs	2,319	367	355	636	436	1,257	737	5	91	69	6,272
Recoveries	16	-	7	24	20	51	85	60	53	62	378
Provision	302	354	52	401	343	1,308	3,618	(366)	-	(10)	6,002
Ending balance	\$5,261	\$107	\$475	\$1,125	\$3,210	\$2,688	\$4,297	\$520	\$122	\$15	\$17,820
Allowance related to:											
Loans individually evaluated for impairment	\$2,762	\$-	\$86	\$241	\$475	\$502	\$3,211	\$28	\$4	\$-	\$7,309
Loans collectively evaluated for impairment	2,499	107	389	884	2,735	2,186	1,086	492	118	15	10,511
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Total	\$5,261	\$107	\$475	\$1,125	\$3,210	\$2,688	\$4,297	\$520	\$122	\$15	\$17,820
Loans individually evaluated for impairment	\$31,138	\$-	\$12,411	\$15,946	\$12,057	\$6,420	\$23,094	\$220	\$43	\$-	\$101,329

Loans collectively evaluated for impairment	51,719	2,087	76,586	134,144	267,075	209,164	39,654	53,235	21,247	2,513	\$857,424
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Total	\$82,857	\$2,087	\$88,997	\$150,090	\$279,132	\$215,584	\$62,748	\$53,455	\$21,290	\$2,513	\$958,753

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

NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

The following tables present our goodwill by reporting unit at September 30, 2012 and other intangible assets by reporting unit at September 30, 2012 and December 31, 2011.

Dollars in thousands	Goodwill Activity		
	Community Banking	Insurance Services	Total
Balance, January 1, 2012	\$ 1,488	\$ 4,710	\$ 6,198
Acquired goodwill, net	-	-	-
Balance, September 30, 2012	\$ 1,488	\$ 4,710	\$ 6,198

Dollars in thousands	Other Intangible Assets					
	September 30, 2012			December 31, 2011		
	Community Banking	Insurance Services	Total	Community Banking	Insurance Services	Total
Unidentifiable intangible assets						
Gross carrying amount	\$ 2,267	\$ -	\$ 2,267	\$ 2,267	\$ -	\$ 2,267
Less: accumulated amortization	2,028	-	2,028	1,914	-	1,914
Net carrying amount	\$ 239	\$ -	\$ 239	\$ 353	\$ -	\$ 353
Identifiable intangible assets						
Gross carrying amount	\$ -	\$ 3,000	\$ 3,000	\$ -	\$ 3,000	\$ 3,000
Less: accumulated amortization	-	1,050	1,050	-	900	900
Net carrying amount	\$ -	\$ 1,950	\$ 1,950	\$ -	\$ 2,100	\$ 2,100

We recorded amortization expense of approximately \$263,000 for the nine months ended September 30, 2012 relative to our other intangible assets. Annual amortization is expected to be approximately \$351,000 for each of the years ending 2012 through 2014.

NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of September 30, 2012 and 2011 and December 31, 2011:

Dollars in thousands	September 30, 2012	December 31, 2011	September 30, 2011
Demand deposits, interest bearing	\$ 177,236	\$ 158,483	\$ 163,840
Savings deposits	197,610	208,809	208,030
Retail time deposits	294,945	328,082	404,363
Wholesale deposits	260,752	232,471	185,670
Total	\$ 930,543	\$ 927,845	\$ 961,903

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

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

A summary of the scheduled maturities for all time deposits as of September 30, 2012 is as follows:

Dollars in thousands	
Three month period ending December 31, 2012	\$ 82,053
Year ending December 31, 2013	181,605
Year ending December 31, 2014	71,313
Year ending December 31, 2015	59,922
Year ending December 31, 2016	79,006
Thereafter	81,798
	\$ 555,697

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, 2012:

Dollars in thousands	Amount	Percent
Three months or less	\$ 57,004	14.6%
Three through six months	21,562	5.5%
Six through twelve months	60,448	15.4%
Over twelve months	252,513	64.5%
Total	\$ 391,527	100.0%

NOTE 10. BORROWED FUNDS

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

Dollars in thousands	Nine Months Ended September 30, 2012		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at September 30	\$ 20,000	\$ -	\$ 957
Average balance outstanding for the period	13,294	-	956
Maximum balance outstanding at any month end during period	20,000	-	957

Weighted average interest rate for the period	0.23	%	0.00	%	0.25%
Weighted average interest rate for balances outstanding at September 30	0.26	%	0.00	%	0.25%

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

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

Dollars in thousands	Nine Months Ended September 30, 2011			
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit	
Balance at September 30	\$ -	\$ -	\$ 955	
Average balance outstanding for the period	-	709	954	
Maximum balance outstanding at any month end during period	-	1,233	955	
Weighted average interest rate for the period	0.00 %	0.15 %	0.25%	
Weighted average interest rate for balances outstanding at September 30	0.00 %	0.00 %	0.25%	

Long-term borrowings: Our long-term borrowings of \$203,744,000, \$270,254,000 and \$272,031,000 at September 30, 2012, December 31, 2011, and September 30, 2011 respectively, consisted primarily of advances from the Federal Home Loan Bank (“FHLB”) and structured reverse repurchase agreements with two unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

Dollars in thousands	Balance at September 30,		Balance at
	2012	2011	December 31, 2011
Long-term FHLB advances	\$ 122,718	\$ 161,651	\$ 160,325
Long-term reverse repurchase agreements	72,000	100,000	100,000
Term loan	9,026	10,380	9,929
Total	\$ 203,744	\$ 272,031	\$ 270,254

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

Our long term borrowings bear both fixed and variable rates and mature in varying amounts through the year 2026.

The average interest rate paid on long-term borrowings for the nine month period ended September 30, 2012 was 3.92% compared to 4.10% for the first nine months of 2011.

Subordinated debentures: We have subordinated debt totaling \$16.8 million at September 30, 2012, December 31, 2011, and September 30, 2011. The subordinated debt qualifies as Tier 2 capital under Federal Reserve Board guidelines until the debt is within 5 years of its maturity; thereafter the amount qualifying as Tier 2 capital is reduced by 20 percent each year until maturity. During 2009, we issued \$6.8 million in subordinated debt, of which \$5 million was issued to an affiliate of a director of Summit. We also issued \$1.0 million and \$0.8 million to two unrelated parties. These three issuances bear an interest rate of 10 percent per annum, a term of 10 years, and are not prepayable by us within the first five years. During 2008, we issued \$10 million of subordinated debt to an unrelated institution, which bears a variable interest rate of 1 month LIBOR plus 275 basis points and a term of 7.5 years.

Subordinated debentures owed to unconsolidated subsidiary trusts: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the “capital securities”) for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the “debentures”). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled \$19,589,000 at September 30, 2012, December 31, 2011, and September 30, 2011.

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

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

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

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

Dollars in thousands	Year Ending	Subordinated debentures owed to Long-term Subordinated unconsolidated subsidiary			
		borrowings	debentures	trusts	
	December 31,	2012	\$ 927	\$ -	\$ -
		2013	41,898	-	-
		2014	83,429	-	-
		2015	1,909	10,000	-
		2016	28,911	-	-
		Thereafter	46,670	6,800	19,589
			\$ 203,744	\$ 16,800	\$ 19,589

NOTE 11. STOCK OPTION PLAN

The 2009 Officer Stock Option Plan was adopted by our shareholders in May 2009 and provides for the granting of stock options for up to 350,000 shares of common stock to our key officers. Each option granted under the Plan vests according to a schedule designated at the grant date and has a term of no more than 10 years following the vesting date. Also, the option price per share was not to be less than the fair market value of our common stock on the date of grant. The 2009 Officer Stock Option Plan, which expires in May 2019, replaces the 1998 Officer Stock

Option Plan (collectively the "Plans") that expired in May 2008.

The fair value of our employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Because our employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options at the time of grant. There were no options granted during the first nine months of 2012 or 2011.

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

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

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

	For the Nine Months Ended September 30,			
	2012	Weighted-Average Exercise Price	2011	Weighted-Average Exercise Price
	Options		Options	
Outstanding, January 1	317,180	\$ 18.17	317,180	\$ 18.17
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Expired	(22,800)	5.12	-	-
Outstanding, September 30	294,380	\$ 19.18	317,180	\$ 18.17

Other information regarding options outstanding and exercisable at September 30, 2012 is as follows:

Range of exercise price	# of shares	Options Outstanding			Options Exercisable		
		Wted. Avg. Remaining Contractual WAEP	Wted. Avg. Remaining Contractual Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of shares	Wted. Avg. Remaining Contractual WAEP	Aggregate Intrinsic Value (in thousands)
2.54 - \$ \$6.00	41,350	\$ 5.16	2.64	\$ 15	38,350	\$ 5.37	\$ 7
6.01 - 10.00	33,680	9.20	3.84	-	32,480	9.31	-
10.01 - 17.50	2,300	17.43	1.42	-	2,300	17.43	-
17.51 - 20.00	51,300	17.79	4.25	-	51,200	17.79	-
20.01 - 25.93	165,750	25.15	3.16	-	165,750	25.15	-
	294,380	19.18		\$ 15	290,080	19.40	\$ 7

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:

37

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

	September 30,
Dollars in thousands	2012
Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 47,234
Construction loans	18,524
Other loans	34,537
Standby letters of credit	1,825
Total	\$ 102,120

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

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

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

NOTE 13. REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). We believe, as of September 30, 2012, that we and each of our subsidiaries met all capital adequacy requirements to which they were subject.

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

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

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

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

Dollars in thousands As of September 30, 2012	Actual		Minimum Required Regulatory Capital		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to risk weighted assets)						
Summit	\$ 138,726	13.8	%\$ 80,134	8.0	%\$ 100,168	10.0%
Summit Community	146,450	14.6	% 80,174	8.0	% 100,217	10.0%
Tier I Capital (to risk weighted assets)						
Summit	113,236	11.3	% 40,067	4.0	% 60,101	6.0%
Summit Community	133,760	13.3	% 40,087	4.0	% 60,130	6.0%
Tier I Capital (to average assets)						
Summit	113,236	8.0	% 56,302	4.0	% 70,378	5.0%
Summit Community	133,760	9.5	% 56,320	4.0	% 70,400	5.0%
As of December 31, 2011						
Total Capital (to risk weighted assets)						
Summit	136,060	13.0	% 83,617	8.0	% 104,522	10.0%
Summit Community	142,329	13.6	% 83,604	8.0	% 104,505	10.0%
Tier I Capital (to risk weighted assets)						
Summit	109,989	10.5	% 41,809	4.0	% 62,713	6.0%
Summit Community	129,058	12.3	% 41,802	4.0	% 62,703	6.0%
Tier I Capital (to average assets)						
Summit	109,989	7.6	% 58,031	4.0	% 72,538	5.0%
Summit Community	129,058	8.9	% 57,995	4.0	% 72,493	5.0%

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

Under the Summit MOU, Summit has agreed among other things to:

§ Summit suspending all cash dividends on its common stock until further notice. Dividends on all preferred stock, as well as interest payments on subordinated notes underlying Summit’s trust preferred securities, continue to be permissible; and,

§ Summit not incurring any additional debt, other than trade payables, without the prior written consent of the principal banking regulators.

Additional information regarding Summit's MOU is included in Part I. Item 1A – Risk Factors on our Form 10-K for the year ended December 31, 2011.

On October 25, 2012, the Bank entered into a revised MOU (“Bank MOU”) which replaced the Bank MOU effective September 24, 2009 and subsequently amended on February 1, 2011. In general, the Bank MOU includes provisions substantially similar to those in the prior Bank MOU with the exception that several provisions deemed no longer applicable by the regulatory authorities were removed and a provision relative to reducing the Bank's levels of classified assets was added.

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

In summary, we have agreed, among other things, to address the following matters relative to the Bank:

- § maintaining a Board committee which monitors and promotes compliance with the provisions of the Bank MOU;
- § providing the Bank's regulatory authorities with updated reports of criticized assets and/or formal workout plans for all nonperforming borrower relationships with an aggregate outstanding balance exceeding \$1 million;
- § developing and submitting to regulatory authorities a written plan to reduce the Bank's risk exposure in each adversely classified credit relationship in excess of \$1 million and all OREO;
- § establishing procedures to report all loans with balances exceeding \$500,000 that have credit weaknesses or that fall outside of the Bank's policy;
 - § annually reviewing the organizational structure and operations of the Bank's loan department;
 - § maintaining an adequate allowance for loan and lease losses through charges to current operating income;
- § reviewing overall liquidity objectives and developing and submitting to regulatory authorities plans and procedures aimed to improve liquidity and reduce reliance on volatile liabilities;
- § preparing comprehensive budgets and earnings forecasts for the Bank and submitting reports comparing actual performance to the budget plan;
- § maintaining a minimum Tier 1 Leverage Capital ratio of at least 8% and a Total Risk-based Capital ratio of at least 11%;
 - § not paying any cash dividends without the prior written consent of the banking regulators; and,
- § providing quarterly progress reports to the Bank's regulatory authorities detailing steps taken to comply with the Bank MOU.

NOTE 14. SEGMENT INFORMATION

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

Intersegment revenue and expense consists of management fees allocated to the bank and Summit Insurance Services, LLC for all centralized functions that are performed by the parent, including overall direction in the areas of strategic planning, investment portfolio management, asset/liability management, financial reporting and other financial and administrative services. Information for each of our segments is included below:

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

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

In thousands	Nine Months Ended September 30, 2012				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 31,264	\$ -	\$ (1,340)	\$ -	\$ 29,924
Provision for loan losses	6,002	-	-	-	6,002
Net interest income after provision for loan losses	25,262	-	(1,340)	-	23,922
Other income	(16)	3,371	765	(783)	3,337
Other expenses	18,886	2,980	1,223	(783)	22,306
Income (loss) before income taxes	6,360	391	(1,798)	-	4,953
Income tax expense (benefit)	1,772	156	(583)	-	1,345
Net income (loss)	4,588	235	(1,215)	-	3,608
Dividends on preferred shares	-	-	583	-	583
Net income (loss) applicable to common shares	\$ 4,588	\$ 235	\$ (1,798)	\$ -	\$ 3,025
Intersegment revenue (expense)	\$ (706)	\$ (77)	\$ 783	\$ -	\$ -
Average assets	\$ 1,486,808	\$ 6,495	\$ 154,011	\$ (218,207)	\$ 1,429,107

In thousands	Nine Months Ended September 30, 2011				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 31,541	\$ -	\$ (1,358)	\$ -	\$ 30,183
Provision for loan losses	8,001	-	-	-	8,001
Net interest income after provision for loan losses	23,540	-	(1,358)	-	22,182
Other income	(1,100)	3,577	1,827	(743)	3,561
Other expenses	18,784	3,173	1,237	(743)	22,451
Income (loss) before income taxes	3,656	404	(768)	-	3,292
Income tax expense (benefit)	741	161	(204)	-	698
Net income (loss)	2,915	243	(564)	-	2,594

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

Dividends on preferred shares	-	-	223	-	223
Net income (loss) applicable to common shares	\$ 2,915	\$ 243	\$ (787)	\$ -	\$ 2,371
Intersegment revenue (expense)	\$ (657)	\$ (86)	\$ 743	\$ -	\$ -
Average assets	\$ 1,537,150	\$ 6,691	\$ 141,377	\$ (210,693)	\$ 1,474,525

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

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

In thousands	Three Months Ended September 30, 2012				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 10,381	\$ -	\$ (446)	\$ -	\$ 9,935
Provision for loan losses	2,000	-	-	-	2,000
Net interest income after provision for loan losses	8,381	-	(446)	-	7,935
Other income	(244)	1,050	261	(261)	806
Other expenses	6,349	1,023	361	(261)	7,472
Income (loss) before income taxes	1,788	27	(546)	-	1,269
Income tax expense (benefit)	430	10	(168)	-	272
Net income (loss)	1,358	17	(378)	-	997
Dividends on preferred shares	-	-	194	-	194
Net income (loss) applicable to common shares	\$ 1,358	\$ 17	\$ (572)	\$ -	\$ 803
Intersegment revenue (expense)	\$ (235)	\$ (26)	\$ 261	\$ -	\$ -
Average assets	\$ 1,473,356	\$ 6,579	\$ 155,168	\$ (220,005)	\$ 1,415,098

In thousands	Three Months Ended September 30, 2011				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 10,374	\$ -	\$ (453)	\$ -	\$ 9,921
Provision for loan losses	2,001	-	-	-	2,001
Net interest income after provision for loan losses	8,373	-	(453)	-	7,920
Other income	1,093	1,121	221	(248)	2,187
Other expenses	6,443	1,032	346	(248)	7,573
Income (loss) before income taxes	3,023	89	(578)	-	2,534
Income tax expense (benefit)	774	35	(211)	-	598
Net income (loss)	2,249	54	(367)	-	1,936
Dividends on preferred shares	-	-	74	-	74

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

Net income (loss) applicable to common shares	\$ 2,249	\$ 54	\$ (441)	\$ -	\$ 1,862
Intersegment revenue (expense)	\$ (219)	\$ (29)	\$ 248	\$ -	\$ -
Average assets	\$ 1,532,356	\$ 6,573	\$ 143,099	\$ (211,854)	\$ 1,470,174

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

INTRODUCTION

The following discussion and analysis focuses on significant changes in our financial condition and results of operations of Summit Financial Group, Inc. ("Company" or "Summit") and our operating segments, Summit Community Bank ("Summit Community"), and Summit Insurance Services, LLC for the periods indicated. See Note 14 of the accompanying consolidated financial statements for our segment information. This discussion and analysis should be read in conjunction with our 2011 audited financial statements and Annual Report on Form 10-K.

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

OVERVIEW

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

Interest earning assets declined by 3.43% for the first nine months in 2012 compared to the same period of 2011 while our net interest earnings on a tax equivalent basis decreased 0.44%. Our tax equivalent net interest margin increased 9 basis points. Historically high levels of nonaccrual loans continue to negatively impact our net interest earnings while our reduced cost of interest bearing funds continues to positively impact our net interest earnings.

BUSINESS SEGMENT RESULTS

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

In thousands	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Community banking	\$ 1,358	\$ 2,249	\$ 4,588	\$ 2,915
Insurance	17	54	235	243
Parent	(572)	(441)	(1,798)	(787)
Consolidated net income	\$ 803	\$ 1,862	\$ 3,025	\$ 2,371

CRITICAL ACCOUNTING POLICIES

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

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

Our most significant accounting policies are presented in the notes to the consolidated financial statements of our 2011 Annual Report on Form 10-K. These policies, along with the other disclosures presented in the financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

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

Allowance for Loan Losses: The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 8 to the consolidated financial statements of our 2011 Annual Report on Form 10-K describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of the financial review of the 2011 Annual Report on Form 10-K.

Goodwill: During 2012, we adopted authoritative guidance that allows us to utilize a qualitative approach to test goodwill for impairment. This authoritative guidance permits us to first perform an assessment of qualitative factors (Step 0) to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying value, then performing the two-step impairment test is unnecessary. However, if we conclude otherwise, then we are required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the fair value is less than the carrying value, an expense may be required on our books to write down the goodwill to the proper carrying value. The second step (Step 2) of impairment testing is necessary only if the reporting unit does not pass Step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination.

Community Banking – During third quarter 2012, we performed the Step 0 assessment of our goodwill of our community banking reporting unit and determined that it was not more likely than not that the fair value was less than its carrying value. Because we did not experience any significant adverse changes in our banking business or its reporting structure since our last 2-step impairment test at September 30, 2011, we performed the qualitative Step 0 assessments. In performing the qualitative Step 0 assessments, we considered certain events and circumstances such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value is less than its carrying amount. No indicators of impairment were noted as of September 30, 2012.

Insurance Services – During third quarter 2012, we performed the Step 0 assessment of our goodwill of our insurance services reporting unit. We considered certain events and circumstances specific to the reporting unit, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value of our insurance services reporting unit is less than its carrying value and deemed it necessary to perform the further 2-step impairment test. We performed an internal valuation utilizing the income approach to determine the fair value of our insurance services reporting unit. This methodology consisted of discounting the expected future cash flows of this unit based upon a forecast of its operations considering long-term key business drivers such as anticipated commission revenue growth. The long term growth rate used in determining the terminal value was estimated at 2%, and a discount rate of 10.5% was applied to the insurance services unit's estimated future cash flows. We did not fail this Step 1 test as of September 30, 2012, therefore Step 2 testing was not necessary.

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

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

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

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

Deferred Income Tax Assets: At September 30, 2012, we had net deferred tax assets of \$11.6 million. Based on our ability to offset the net deferred tax asset against taxable income in carryback years and expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at September 30, 2012. All available evidence, both positive and negative, was considered to determine whether, based on the weight of that evidence, impairment should be recognized. However, our forecast process includes judgmental and quantitative elements that may be subject to significant change. If our forecast of taxable income within the carryback/carryforward periods available under applicable law is not sufficient to cover the amount of net deferred tax assets, such assets may become impaired.

RESULTS OF OPERATIONS

Earnings Summary

Net income applicable to common shares for the nine months ended September 30, 2012 increased to \$3,025,000, or \$0.38 per diluted share as compared to \$2,371,000 or \$0.32 per diluted share for the same period of 2011. Net income applicable to common shares for the quarter ended September 30, 2012 totaled \$803,000, or \$0.10 per diluted share as compared to \$1,862,000, or \$0.24 per diluted share for the quarter ended September 30, 2011. Earnings for nine months ended September 30, 2012 were positively impacted by lower provisions for loan losses and lower other-than-temporary-impairment of securities, and negatively impacted by our continued write-downs of foreclosed properties to their estimated fair values and losses on sales of assets, primarily foreclosed properties.

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

Earnings for the quarter ended September 30, 2012 were primarily negatively impacted by our continued write-downs of foreclosed properties to their estimated fair values. The provision for loan losses was \$6.0 million and \$8.0 million for the nine months ended September 30, 2012 and 2011, respectively. Included in earnings for the nine months ended September 30, 2012 was \$2.3 million of realized securities gains, \$583,000 in losses on the sales of assets, primarily foreclosed properties, \$6.1 million of charges resulting from the write down of a portion of our foreclosed properties to fair value and \$375,000 in other than temporary impairment charges on securities. Returns on average equity and assets for the first nine months of 2012 were 4.54% and 0.34%, respectively, compared with 3.76% and 0.23% for the same period of 2011.

Net Interest Income

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

Our net interest income on a fully tax-equivalent basis totaled \$31,071,000 for the nine months ended September 30, 2012 compared to \$31,209,000 for the same period of 2011, representing a decrease of \$138,000 or 0.44%. While our tax-equivalent earnings on interest earning assets decreased \$5,176,000, this decrease was nearly offset by a reduction in the volume of interest bearing liabilities and a reduction in the cost of interest bearing liabilities (see Table II). Average interest earning assets decreased 3.43% from \$1,347,588,000 during the first nine months of 2011 to \$1,301,378,000 for the first nine months of 2012. Average interest bearing liabilities declined 5.20% from \$1,289,493,000 at September 30, 2011 to \$1,222,472,000 at September 30, 2012, at an average yield for the first nine months of 2012 of 2.05% compared to 2.47% for the same period of 2011.

Our consolidated net interest margin increased to 3.19% for the nine months ended September 30, 2012, compared to 3.10% for the same period in 2011. The margin continues to be affected by elevated levels of nonaccruing loans. The present continued low interest rate environment has served to positively impact our net interest margin due to our liability sensitive balance sheet. For the nine months ended September 30, 2012 compared to September 30, 2011, the yields on earning assets decreased 35 basis points, while the cost of our interest bearing funds decreased by 42 basis points.

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

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

Table I - Average Balance Sheet and Net Interest Income

Analysis

Dollars in thousands

	For the Nine Months Ended						
	September 30, 2012			September 30, 2011			
	Average Balance	Earnings/ Expense	Yield/ Rate		Average Balance	Earnings/ Expense	Yield/ Rate
Interest earning assets							
Loans, net of unearned income (1)							
Taxable	\$ 965,227	\$ 41,811	5.79 %		\$ 987,928	\$ 44,622	6.04%
Tax-exempt (2)	6,776	368	7.25 %		4,765	289	8.11%
Securities							
Taxable	235,885	4,592	2.60 %		262,275	7,290	3.72%
Tax-exempt (2)	70,753	3,009	5.68 %		56,313	2,727	6.47%
Federal funds sold and interest bearing deposits with other banks	22,737	31	0.18 %		36,307	59	0.22%
Total interest earning assets	1,301,378	49,811	5.11 %		1,347,588	54,987	5.46%
Noninterest earning assets							
Cash & due from banks	4,195				3,951		
Premises and equipment	21,684				22,737		
Other assets	120,041				118,393		
Allowance for loan losses	(18,191)				(18,144)		
Total assets	\$ 1,429,107				\$ 1,474,525		
Interest bearing liabilities							
Interest bearing demand deposits	\$ 167,843	\$ 247	0.20 %		\$ 151,137	\$ 296	0.26%
Savings deposits	206,953	1,054	0.68 %		206,705	1,473	0.95%
Time deposits	545,121	8,839	2.17 %		611,404	12,202	2.67%
Short-term borrowings	14,250	25	0.23 %		1,663	3	0.24%
Long-term borrowings and capital trust securities	288,305	8,575	3.97 %		318,584	9,804	4.11%

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

Total interest bearing liabilities	1,222,472	18,740	2.05 %	1,289,493	23,778	2.47%
Noninterest bearing liabilities and shareholders' equity						
Demand deposits	92,362			83,768		
Other liabilities	8,273			9,234		
Total liabilities	1,323,107			1,382,495		
Shareholders' equity - preferred						
	9,326			3,532		
Shareholders' equity - common						
	96,674			88,498		
Total liabilities and shareholders' equity						
	\$ 1,429,107			\$ 1,474,525		
Net interest earnings		\$ 31,071			\$ 31,209	
Net yield on interest earning assets			3.19 %			3.10%

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

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

The tax equivalent adjustment resulted in an increase in interest income of \$1,145,000 and \$1,026,000 for the periods ended

September 30, 2012 and September 30, 2011, respectively.

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

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

In thousands	For the Nine Months Ended		
	September 30, 2012 versus September 30, 2011		
	Increase (Decrease) Due to Change in:		
	Volume	Rate	Net
Interest earned on:			
Loans			
Taxable	\$ (996)	\$ (1,815)	\$ (2,811)
Tax-exempt	112	(33)	79
Securities			
Taxable	(678)	(2,020)	(2,698)
Tax-exempt	643	(361)	282
Federal funds sold and interest			
bearing deposits with other banks	(19)	(9)	(28)
Total interest earned on interest earning assets	(938)	(4,238)	(5,176)
Interest paid on:			
Interest bearing demand deposits			
deposits	31	(80)	(49)
Savings deposits	2	(421)	(419)
Time deposits	(1,229)	(2,134)	(3,363)
Short-term borrowings	22	-	22
Long-term borrowings and capital			
trust securities	(903)	(326)	(1,229)
Total interest paid on interest bearing liabilities	(2,077)	(2,961)	(5,038)
Net interest income	\$ 1,139	\$ (1,277)	\$ (138)

Noninterest Income

Total noninterest income decreased to \$3,337,000 for the first nine months of 2012, compared to \$3,561,000 for the same period of 2011, with losses on the sales of assets, primarily foreclosed properties, lower realized securities gains and writedowns of foreclosed properties to their estimated fair value being the primary negative components. Further detail regarding noninterest income is reflected in the following table.

Table III - Noninterest
Income

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

Dollars in thousands	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Insurance commissions	\$ 1,052	\$ 1,073	\$ 3,352	\$ 3,458
Service fees related to deposit accounts	1,074	1,078	3,163	3,024
Realized securities gains	760	1,517	2,245	3,463
Other-than-temporary impairment of securities	(39)	(484)	(375)	(2,245)
Gain (loss) on sales of assets	16	130	(583)	277
Bank owned life insurance income	257	273	781	576
Write-downs of foreclosed properties	(2,571)	(1,637)	(6,114)	(5,770)
Other	257	237	868	778
Total	\$ 806	\$ 2,187	\$ 3,337	\$ 3,561

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

Other-than-temporary impairment of securities: During the first nine months of 2012, we recorded non-cash other-than temporary impairment charges of \$375,000 related to certain residential mortgage-backed securities which we continue to own.

Gain/(loss) on sales of assets: During the first nine months of 2012, we recognized \$583,000 in losses on sales of assets, principally foreclosed properties.

Write-downs of foreclosed properties: During the first nine months of 2012, we recorded \$6,114,000 in charges to writedown certain OREO properties to fair value less estimated costs to sell as part of our normal, ongoing re-appraisal process. Continued volatility in the real estate markets could result in further write-downs of these properties in the foreseeable future.

Noninterest Expense

Total noninterest expense decreased slightly for the nine months ended September 30, 2012, as compared to the same period in 2011. While professional fees, primarily related to complex collection issues relative to our problem assets, remain elevated, foreclosed properties expense decreased for the nine months ended September 30, 2012. FDIC premiums are lower in 2012 due to our lower deposit base and a change in the assessment base used in calculating FDIC premiums that became effective during second quarter 2011. Other expenses are higher for the nine months ended September 30, 2012 due to the refund during first quarter 2011 of Virginia business franchise taxes. Table IV below shows the breakdown of the changes.

Table IV -
Noninterest
Expense

Dollars in thousands	For the Quarter Ended September 30, Change				For the Nine Months Ended September 30, Change			
	2012	\$	%	2011	2012	\$	%	2011
Salaries, commissions, and employee benefits	\$ 3,940	\$ (19)	-0.5 %	\$ 3,959	\$ 11,733	\$ (254)	-2.1 %	\$ 11,987
Net occupancy expense	476	3	0.6 %	473	1,445	(18)	-1.2 %	1,463
Equipment expense	576	(13)	-2.2 %	589	1,773	23	1.3 %	1,750
Professional fees	250	(15)	-5.7 %	265	781	127	19.4 %	654
Amortization of intangibles	88	-	0.0 %	88	263	-	0.0 %	263
FDIC premiums	510	(70)	-12.1 %	580	1,532	(327)	-17.6 %	1,859
Foreclosed properties expense	395	6	1.5 %	389	1,017	(218)	-17.7 %	1,235
Other	1,237	7	0.6 %	1,230	3,762	522	16.1 %	3,240
Total	\$ 7,472	\$ (101)	-1.3 %	\$ 7,573	\$ 22,306	\$ (145)	-0.6 %	\$ 22,451

Credit Experience

Due to continued recessionary economic conditions, borrowers have in many cases been unable to refinance their loans to a range of factors including declining property values and elevated unemployment levels. As a result, we have experienced higher delinquencies and nonperforming assets, particularly with regard to our construction & development, residential real estate, and commercial real estate loan portfolios. It is not known when the housing market will stabilize. Management anticipates loan delinquencies will remain higher than historical levels in the near term, and we anticipate that nonperforming assets will remain elevated for the foreseeable future.

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

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

We recorded \$6,002,000 and \$8,001,000 provisions for loan losses for the first nine months of 2012 and 2011, respectively. Although the level of impaired loans has increased over the past year as well as specific reserves on impaired loans, the level of historic charge-offs has continued to decline, requiring lower levels of FAS 5 reserves.

As illustrated in Table V below, our non-performing assets have decreased since year end 2011.

Table V - Summary of
Non-Performing Assets

Dollars in thousands	2012	September 30, 2011	December 31, 2011
Accruing loans past due 90 days or more	\$ -	\$ -	\$ 344
Nonaccrual loans			
Commercial	5,343	3,473	3,260
Commercial real estate	2,803	8,398	7,163
Commercial construction and development	428	-	1,052
Residential construction and development	16,333	17,506	22,289
Residential real estate	18,809	6,818	18,187
Consumer	88	87	145
Total nonaccrual loans	43,804	36,282	52,096
Foreclosed properties			
Commercial	-	-	-
Commercial real estate	11,802	14,256	15,721
Commercial construction and development	17,683	16,960	17,101
Residential construction and development	23,769	27,804	27,877
Residential real estate	2,779	3,718	3,239
Consumer	-	-	-
Total foreclosed properties	56,033	62,738	63,938
Repossessed assets	-	859	263
Total nonperforming assets	\$ 99,837	\$ 99,879	\$ 116,641
Total nonperforming loans as a			
percentage of total loans	4.57 %	3.69 %	5.33%
Total nonperforming assets as a			
percentage of total assets	7.11 %	6.82 %	8.04%

The following table details the activity regarding our foreclosed properties for the three months and nine months ended September 30, 2012 and 2011.

Table VI - Foreclosed Property Activity	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Dollars in thousands				
Beginning balance	\$ 60,068	\$ 65,591	\$ 63,938	\$ 69,638
Acquisitions	241	4,803	5,262	9,035
Improvements	155	295	677	905
Disposals	(1,860)	(6,314)	(7,309)	(11,070)
Writedowns to fair value	(2,571)	(1,637)	(6,114)	(5,770)
Reclassification of covered loans	-	-	(421)	-
Balance September 30	\$ 56,033	\$ 62,738	\$ 56,033	\$ 62,738

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

The following table details our most significant nonperforming loan relationships at September 30, 2012.

Table VII - Significant Nonperforming Loan Relationships

September 30, 2012

Dollars in thousands

Location	Underlying Collateral	Loan Origination Date	Loan Nonaccrual Date	Loan Balance	Method Used to Measure Impairment	Most Recent Appraised Value	Amount Allocated to Allowance for Loan Losses	Amount Previously Charged-off
Southwestern WV	Accounts Receivable, Inventory, Equipment, & Commercial Real Estate	Oct. 2007	Jun. 2012	\$3,371	PV Cash Flow	\$3,311(2)	\$-	\$-
Northern VA	Five residential lots, one commercial lot, and one single family residence	Jun. 2005, July 2005, Sept. 2005, Jan. 2006, & Aug. 2006	Jun. 2012	\$2,524	Collateral Value	\$2,810(1)	\$1,099	\$-
Shenandoah Valley, VA	Residential Building Lots	Aug. 2004, July 2005, & July 2007	Jun. 2011	\$2,067	Collateral value	\$1,860(1)	\$420	\$-
Northern VA	Single family residence & Business Investment	Aug. 2007, Oct. 2007 & Sept. 2008	Dec. 2011	\$12,562	Collateral value	\$15,714(2)	\$3,062	\$-
Eastern Panhandle, WV	Residential development & undeveloped acreage	Mar. 2008 & June 2008	Jun. 2011	\$8,380	Collateral value	\$8,158(1)	\$1,100	\$-
Shenandoah Valley, VA	Residential Subdivision & 2 single family residential building lots	Jun. 2008	Sept. 2011	\$2,149	Collateral value	\$1,792(1)	\$516	\$-

Eastern Panhandle, WV	2 Single family residences & undeveloped acreage	Dec. 2008 & Jun. 2011	Jul. 2012 & Aug. 2012	\$1,081	Collateral Value	\$2,122(1)	\$-
Southcentral WV	UCC Business Assets & Residential Subdivision	Feb. 2003, Mar. 2008 & Apr. 2008	May 2011 & Jul. 2011	\$1,246	Collateral value	\$1,624(2)	\$36 \$-

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

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

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

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

Specific Reserve for Loans Individually Evaluated

First, we identify loan relationships having aggregate balances in excess of \$500,000 and that may also have credit weaknesses. Such loan relationships are identified primarily through our analysis of internal loan evaluations, past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – that is, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of our impaired loans are and historically have been collateral dependent, meaning repayment of the

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

loan is expected to be provided solely from the sale of the loan's underlying collateral. For such loans, we measure impairment based on the fair value of the loan's collateral, which is generally determined utilizing current appraisals. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell. Our policy is to re-evaluate the fair value of collateral dependent loans at least every twelve months unless there is a known deterioration in the collateral's value, in which case a new appraisal is obtained.

Quantitative Reserve for Loans Collectively Evaluated

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

Quantitative reserves relative to each loan pool are established as follows: for all loan segments detailed above an allocation equaling 100% of the respective pool's average 12 month historical net loan charge-off rate (determined based upon the most recent twelve quarters) is applied to the aggregate recorded investment in the pool of loans.

Qualitative Reserve for Loans Collectively Evaluated

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

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

In analyzing the relationship between the allowance for loan losses, net loan charge-offs and nonperforming loans, it is helpful to understand the process of how loans are treated as they deteriorate over time. Reserves for loans are established at origination through the quantitative and qualitative reserve process discussed above.

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

Consumer loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days

from receiving notification about a specified event (e.g., bankruptcy of the borrower), whichever is earlier.

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

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.

Commercial-related loans (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination includes many factors, including the prioritization of our claim in bankruptcy, expectations of the workout/restructuring of the loan and valuation of the borrower's equity.

Substantially all of our nonperforming loans are secured by real estate. The substantial majority of these loans were underwritten in accordance with our loan-to-value policy guidelines which range from 70-85% at the time of origination. Although property values have deteriorated across our market areas, the fair values of the underlying collateral value remains in excess of the recorded investment in many of our nonperforming loans, and therefore, no specific reserve allocation is required; as of September 30, 2012, approximately 60% of our impaired loans required no reserves or have been charged down to their fair value. Our allowance may or may not fluctuate proportionately as our nonperforming loans fluctuate. The allowance for loan loss will, however, increase as a result of an increase in net loan charge-offs due to the incremental higher historical net charge-off rate applied to the loans which are collectively evaluated for impairment.

At September 30, 2012, our allowance for loan losses totaled \$17,820,000, or 1.86% of total loans, and is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio. At December 30, 2011 and September 30, 2011, our allowance for loan losses totaled \$17,712,000, or 1.80% of total loans and \$17,949,000, or 1.82% of total loans, respectively.

At September 30, 2012, December 31, 2011, and September 30, 2011, we had approximately \$56,033,000, \$63,938,000 and \$62,738,000, respectively, in other real estate owned which was obtained as the result of foreclosure proceedings. Although foreclosed property is recorded at fair value less estimated costs to sell, the prices ultimately realized upon their sale may or may not result in us recognizing loss.

FINANCIAL CONDITION

Our total assets were \$1,404,086,000 at September 30, 2012, compared to \$1,450,121,000 at December 31, 2011, representing a 3.17% decrease. Table VIII below serves to illustrate significant changes in our financial position between December 31, 2011 and September 30, 2012.

Table VIII - Summary of Significant Changes in Financial Position

Dollars in thousands	Balance	Increase (Decrease)			Balance
	December 31, 2011	Amount	Percentage		September 30, 2012
Assets					
Securities available for sale	\$ 286,599	5,393	1.9	%	\$ 291,992
Loans, net of unearned interest	983,228	(24,475)	-2.5	%	958,753

Liabilities						
Deposits	\$	1,016,500	\$	10,807	1.1	% \$ 1,027,307
Short-term borrowings		15,956		5,001	31.3	% 20,957
Long-term borrowings		270,254		(66,510)	-24.6	% 203,744
Subordinated debentures		16,800		-	0.0	% 16,800
Subordinated debentures owed to unconsolidated subsidiary trusts		19,589		-	0.0	% 19,589

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

Loans decreased 2.5% and securities increased 1.9% during the first nine months of 2012. We have slowed our loan growth due to the current weakened economic conditions in our market areas and limited availability of new capital resources.

Deposits increased approximately \$10.8 million during the first nine months of 2012; wholesale deposits increased approximately \$28.3 million while retail deposits decreased approximately \$17.5 million.

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

Refer to Notes 5, 6, 9, and 10 of the notes to the accompanying consolidated financial statements for additional information with regard to changes in the composition of our securities, loans, deposits and borrowings between September 30, 2012 and December 31, 2011.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity reflects our ability to ensure the availability of adequate funds to meet loan commitments and deposit withdrawals, as well as provide for other transactional requirements. Liquidity is provided primarily by funds invested in cash and due from banks (net of float and reserves), Federal funds sold, non-pledged securities, and available lines of credit with the Federal Home Loan Bank of Pittsburgh ("FHLB"), Federal Reserve Bank of Richmond and correspondent banks, which totaled approximately \$427 million or 30.4% of total consolidated assets at September 30, 2012.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit activity. As a member of the FHLB, we have access to approximately \$322 million. As of September 30, 2012 and December 31, 2011, these advances totaled approximately \$143 million and \$175 million, respectively. At September 30, 2012, we had additional borrowing capacity of \$179 million through FHLB programs. We have established lines with the Federal Reserve Bank, secured by a pledge of our consumer and commercial and industrial loan portfolios, and a correspondent bank to be used as a contingency liquidity vehicle. The amount available on these lines at September 30, 2012 approximated \$94 million. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises.

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

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

liquidity circumstances and our related contingency plans with respect to each.

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

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

- Would have limited amounts of maturing brokered deposits to replace in the short-term, as we have limited our brokered deposits maturing in any one quarter to no more than \$50 million.
- Presently has \$427 million in available sources of liquid funds which could be drawn upon to fund maturing brokered deposits until Summit Community had restored its capital to well capitalized status.
- Would first seek to restore its capital to well capitalized status through capital contributions from Summit, its parent holding company.
- Would generally have no more than \$100 million in brokered deposits maturing in any one year time frame, which is well within its presently available sources of liquid funds, if in the event Summit does not have the capital resources to restore Summit Community's capital to well capitalized status. One year would give Summit Community ample time to raise alternative funds either through retail deposits or the sale of assets, and obtain capital resources to restore it to well capitalized status.

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

- Would severely curtail lending and other growth activities until such time as access to this line could be restored, thus eliminating the need for net new advances, and
- Would still have available current liquid funding sources secured by unencumbered loans and securities totaling \$277 million aside from its FHLB line, which would result in a funding source of approximately \$234 million.

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

- Presently has \$427 million in available sources of liquid funds which could be drawn upon immediately to fund any "net run off" of deposits from this activity.
- Would severely curtail lending and other growth activities so as to preserve the availability of as much contingency funds as possible.
- Would begin offering its own competitive deposit program when deemed prudent so as to restore the retail deposits lost to the competition.

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

One of our continuous goals is maintenance of a strong capital position. Through management of our capital resources, we seek to provide an attractive financial return to our shareholders while retaining sufficient capital to support future growth. Shareholders' equity at September 30, 2012 totaled \$107,328,000 compared to \$102,566,000 at December 31, 2011.

Summit and Summit Community have each entered into informal Memoranda of Understanding ("MOU's") with their respective regulatory authorities. A memorandum of understanding is characterized by the regulatory authorities as an informal action that is not published or publicly available and that is used when circumstances warrant a milder form

of action than a formal supervisory action, such as a formal written agreement or order. Among other things, under the MOU's, Summit's management team has agreed to:

55

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

- Summit Community maintaining a minimum Tier 1 leverage capital ratio of at least 8% and a total risk-based capital ratio of at least 11%;
- Summit Community shall not pay any cash dividends without the prior written consent of the banking regulators;
- Summit suspending all cash dividends on its common stock until further notice. Dividends on all preferred stock, as well as interest payments on subordinated notes underlying Summit's trust preferred securities, continue to be permissible; and,
- Summit not incurring any additional debt, other than trade payables, without the prior written consent of the banking regulators.

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

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

Although dividends from Summit Community are the principal source of funds to pay dividends, interest, and principal payments on Summit's preferred stock, subordinated debentures (including those owed to unconsolidated subsidiary trusts), and term bank borrowing, we currently have sufficient cash on hand to continue to service our subordinated debentures and term bank borrowing obligations as well as the dividend payments on our preferred stock through at least early 2014. Nevertheless, we can make no assurances that we will continue to have sufficient funds available for Summit's debt service and for distributions to the holders of our preferred stock.

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

CONTRACTUAL CASH OBLIGATIONS

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at September 30, 2012.

Table IX - Contractual Cash Obligations	Long Term	Capital	
		Trust	Operating
Dollars in thousands	Debt	Securities	Leases
2012	\$ 927	\$ -	\$ 61
2013	41,898	-	235
2014	83,429	-	175
2015	11,909	-	21
2016	28,911	-	-

Thereafter	53,470	19,589	-
Total	\$ 220,544	\$ 19,589	\$ 492

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

OFF-BALANCE SHEET ARRANGEMENTS

We are involved with some off-balance sheet arrangements that have or are reasonably likely to have an effect on our financial condition, liquidity, or capital. These arrangements at September 30, 2012 are presented in the following table.

Table X - Off-Balance Sheet Arrangements Dollars in thousands Commitments to extend credit:	September 30, 2012
Revolving home equity and credit card lines	\$ 47,234
Construction loans	18,524
Other loans	34,537
Standby letters of credit	1,825
Total	\$ 102,120

MARKET RISK MANAGEMENT

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

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position is liability sensitive. The nature of our lending and funding activities tends to drive our interest rate risk position to being liability sensitive. That is, absent any changes in the volumes of our interest earning assets or interest bearing liabilities, liabilities are likely to reprice

faster than assets, resulting in a decrease in net income in a rising rate environment. Net income would increase in a falling interest rate environment. Net income is also subject to changes in the shape of the yield curve. In general, a flattening yield curve would result in a decline in our earnings due to the compression of earning asset yields and funding rates, while a steepening would result in increased earnings as margins widen.

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

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of September 30, 2012. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable

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

thereafter for the down 100 and the up 200 scenarios, and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above and are well within our ALCO policy limit, which is a 10% reduction in net interest income over the ensuing twelve month period.

Change in Interest Rates (basis points)	Estimated % Change in Net Interest Income Over:	
	0-12	13-24
	Months	Months
Down 100 (1)	0.52	% 7.12%
Up 200 (1)	-1.95	% -1.52%
Up 400 (2)	-0.65	% -2.68%

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

CONTROLS AND PROCEDURES

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of September 30, 2012, an evaluation of the effectiveness of disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of September 30, 2012 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011.

Item 6. Exhibits

Exhibit 3.i	Amended and Restated Articles of Incorporation of Summit Financial Group, Inc
Exhibit 3.ii	Articles of Amendment 2009
Exhibit 3.iii	Articles of Amendment 2011
Exhibit 3.iv	Amended and Restated By-Laws of Summit Financial Group, Inc.
Exhibit 11	Statement re: Computation of Earnings per Share – Information contained in Note 4 to the Consolidated Financial Statements on page 15 of this Quarterly Report is incorporated herein by reference.
Exhibit 31.1	Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer
Exhibit 31.2	Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer
Exhibit 32.1	Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer
Exhibit 32.2	Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer
Exhibit 101	Interactive Data File (XBRL)

SIGNATURES

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

SUMMIT FINANCIAL GROUP, INC.
(registrant)

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

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

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

Date: November 7, 2012

EXHIBIT INDEX

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

* Furnished, not filed.

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

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

(d) Incorporated by reference to Exhibit 3.2 of Summit Financial Group, Inc.'s filing on Form 10-Q dated June 30, 2006.

