

SUMMIT FINANCIAL GROUP INC
Form 10-Q
May 03, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10 – Q

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

For the quarterly period ended March 31, 2011.

or

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

Commission File Number 0-16587

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

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

55-0672148
(IRS Employer
Identification No.)

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

(304) 530-1000

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

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

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

Yes No

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

Common Stock, \$2.50 par value
7,425,472 shares outstanding as of April 29, 2011

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

Dollars in thousands	March 31, 2011 (unaudited)	December 31, 2010 (*)	March 31, 2010 (unaudited)
ASSETS			
Cash and due from banks	\$4,263	\$4,652	\$5,163
Interest bearing deposits with other banks	46,448	45,696	9,032
Securities available for sale	293,240	271,730	262,565
Other investments	21,956	22,941	24,008
Loans held for sale, net	402	343	429
Loans, net	979,387	995,319	1,112,526
Property held for sale	66,961	70,235	50,562
Premises and equipment, net	22,784	23,092	24,001
Accrued interest receivable	5,797	5,879	6,519
Intangible assets	8,914	9,002	9,265
Other assets	32,043	29,581	32,426
Total assets	\$1,482,195	\$1,478,470	\$1,536,496
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	\$86,735	\$74,604	\$71,100
Interest bearing	975,384	962,335	939,936
Total deposits	1,062,119	1,036,939	1,011,036
Short-term borrowings	1,879	1,582	27,456
Long-term borrowings	283,516	304,109	361,335
Subordinated debentures	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	8,964	9,630	9,746
Total liabilities	1,392,867	1,388,649	1,445,962
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
Common stock and related surplus - authorized 20,000,000 shares;			
\$2.50 par value; issued and outstanding 2011 and 2010 - 7,425,472 shares	24,515	24,508	24,508
Retained earnings	60,879	61,201	63,519
Accumulated other comprehensive income (loss)	415	593	(1,012)
Total shareholders' equity	89,328	89,821	90,534
Total liabilities and shareholders' equity	\$1,482,195	\$1,478,470	\$1,536,496

(*) - December 31, 2010 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated Financial Statements

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

Dollars in thousands, except per share amounts	Three Months Ended	
	March 31,	March 31,
	2011	2010
Interest income		
Interest and fees on loans		
Taxable	\$ 15,075	\$ 16,958
Tax-exempt	65	83
Interest and dividends on securities		
Taxable	2,609	3,138
Tax-exempt	434	455
Interest on interest bearing deposits with other banks	17	11
Total interest income	18,200	20,645
Interest expense		
Interest on deposits	4,743	5,498
Interest on short-term borrowings	1	57
Interest on long-term borrowings and subordinated debentures	3,354	4,858
Total interest expense	8,098	10,413
Net interest income	10,102	10,232
Provision for loan losses	3,000	5,350
Net interest income after provision for loan losses	7,102	4,882
Other income		
Insurance commissions	1,242	1,209
Service fees	621	707
Realized securities gains (losses)	1,628	264
Gain (loss) on sale of assets	71	12
Writedown of OREO	(3,443)	-
Other	497	353
Total other-than-temporary impairment loss on securities	(1,828)	(454)
Portion of loss recognized in other comprehensive income	600	425
Net impairment loss recognized in earnings	(1,228)	(29)
Total other income	(612)	2,516
Other expense		
Salaries, commissions, and employee benefits	3,842	3,724
Net occupancy expense	509	521
Equipment expense	580	629
Supplies	78	109
Professional fees	196	274
Amortization of intangibles	88	88
FDIC premiums	693	825

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OREO expense	434	232
Other	556	1,208
Total other expense	6,976	7,610
Income (loss) before income taxes	(486)	(212)
Income tax expense (benefit)	(238)	(332)
Net Income (loss)	(248)	120
Dividends on preferred shares	74	74
Net Income (loss) applicable to common shares	\$ (322)	\$ 46
Basic earnings per common share	\$ (0.04)	\$ 0.01
Diluted earnings per common share	\$ (0.04)	\$ 0.01

See Notes to Consolidated Financial Statements

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

Dollars in thousands, except per share amounts	Common Stock and Related Surplus	Preferred Stock and Related Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2010	\$24,508	\$3,519	\$61,201	\$ 593	\$89,821
Three Months Ended March 31, 2011					
Comprehensive income:					
Net income (loss)	-	-	(248)	-	(248)
Other comprehensive income:					
Non-credit related other-than-temporary impairment on available for sale debt securities of \$594, net of deferred taxes of \$226	-	-	-	(372)	(372)
Net unrealized gain on available for sale debt securities of \$312 net of deferred taxes of \$118 and reclassification adjustment for net realized gains included in net income of \$1,628	-	-	-	194	194
Total comprehensive income					(426)
Exercise of stock options	-	-	-	-	-
Stock compensation expense	7	-	-	-	7
Preferred stock cash dividends declared (\$20.00 per share)	-	-	(74)	-	(74)
Balance, March 31, 2011	\$24,515	\$3,519	\$60,879	\$ 415	\$89,328
Balance, December 31, 2009	\$24,508	\$3,519	\$63,474	\$ (841)	\$90,660
Three Months Ended March 31, 2010					
Comprehensive income:					
Net income (loss)	-	-	120	-	120
Other comprehensive income:					

Non-credit related other-than-temporary impairment on available for sale debt securities of \$425, net of deferred taxes of \$161	-	-	-	(264)	(264)
Net unrealized gain on available for sale debt securities of \$150 net of deferred taxes of \$57 and reclassification adjustment for net realized gains included in net income of \$264	-	-	-	93		93	
Total comprehensive income						(51)
Exercise of stock options	-	-	-	-		-	
Stock compensation expense	-	-	-	-		-	
Preferred stock cash dividends declared (\$20.00 per share)	-	-	(75)	-	(75)
Balance, March 31, 2010	\$24,508	\$3,519	\$63,519	\$ (1,012)	\$90,534	

See Notes to Consolidated
Financial Statements

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

Dollars in thousands	Three Months Ended	
	March 31, 2011	March 31, 2010
Cash Flows from Operating Activities		
Net income (loss)	\$ (248)	\$ 120
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	362	407
Provision for loan losses	3,000	5,350
Stock compensation expense	7	-
Deferred income tax (benefit)	(1,630)	(437)
Loans originated for sale	(2,715)	(1,781)
Proceeds from loans sold	2,656	1,354
Securities (gains)	(1,628)	(264)
Other-than-temporary impairment of debt securities	1,228	29
(Gain) on disposal of other repossessed assets & property held for sale	(71)	(12)
Write down of other repossessed assets & property held for sale	3,443	-
Amortization of securities premiums (accretion of discounts), net	373	(302)
Amortization of goodwill and purchase accounting adjustments, net	91	91
Increase (decrease) in accrued interest receivable	82	(196)
(Increase) in other assets	(973)	(1,574)
Increase (decrease) in other liabilities	(665)	739
Net cash provided by operating activities	3,312	3,524
Cash Flows from Investing Activities		
Proceeds from (purchase of) interest bearing deposits		
with other banks	(752)	25,215
Proceeds from maturities and calls of securities available for sale	2,889	6,034
Proceeds from sales of securities available for sale	13,256	4,078
Principal payments received on securities available for sale	17,311	13,144
Purchases of securities available for sale	(55,226)	(13,907)
Redemption of Federal Home Loan Bank Stock	986	-
Net principal payments received on loans	11,225	8,792
Purchases of premises and equipment	(54)	(175)
Proceeds from sales of other repossessed assets & property held for sale	1,855	462
Net cash provided by (used in) investing activities	(8,510)	43,643

Cash Flows from Financing Activities			
Net increase in demand deposit, NOW and			
savings accounts	50,571		6,935
Net (decrease) in time deposits	(25,391)		(13,236)
Net increase (decrease) in short-term borrowings	296		(22,284)
Repayment of long-term borrowings	(20,593)		(20,158)
Dividends paid on preferred stock	(74)		(74)
Net cash provided by (used in) financing activities	4,809		(48,817)
(Decrease) in cash and due from banks	(389)		(1,650)
Cash and due from banks:			
Beginning	4,652		6,813
Ending	\$ 4,263		\$ 5,163

(Continued)

See Notes to Consolidated Financial Statements

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

Dollars in thousands	2011	Three Months Ended March 31,	March 31, 2010
Supplemental Disclosures of Cash Flow Information			
Cash payments for:			
Interest	\$	8,311	\$ 10,636
Income taxes	\$	-	\$ -
Supplemental Schedule of Noncash Investing and Financing Activities			
Other assets acquired in settlement of loans	\$	1,707	\$ 10,668

See Notes to Consolidated Financial Statements

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

NOTE 1. BASIS OF PRESENTATION

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

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

The results of operations for the quarter ended March 31, 2011 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 2010 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2010 and March 31, 2010, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

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

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

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

ASU 2010-20 will be effective for our financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period were effective January 1, 2011 and had no impact on our financial statements.

ASU No. 2011-01, Receivables (Topic 310) – Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 temporarily delayed the effective date of the disclosures regarding troubled debt restructurings in ASU No. 2010-20 for public entities. The effective date is for interim and annual reporting periods ending after June 15, 2011.

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

ASU 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring provides additional guidance to clarify when a loan modification or restructuring is considered a troubled debt restructuring (TDR) in order to address current diversity in practice and lead to more consistent application of U.S. GAAP for debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. The amendments to Topic 310 clarify the guidance regarding the evaluation of both considerations above. Additionally, the amendments clarify that a creditor is precluded from using the effective interest rate test in the debtor's guidance on restructuring of payables (paragraph 470-60-55-10) when evaluating whether a restructuring constitutes a TDR. This amendment is effective for us July 1, 2011. Early adoption is permitted. Retrospective application to the beginning of the annual period of adoption for modifications occurring on or after the beginning of the annual adoption period is required. As a result of applying these amendments, we may identify receivables that are newly considered to be impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011.

ASU No. 2010-28, Intangibles – Goodwill and Other (Topic 350) – When to Perform Step 2 of the goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples in paragraph 350-20-35-30, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This amendment was effective for us January 1, 2011 and had no 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 contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, Accounting by Creditors for Impairment of a Loan. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At March 31, 2011, 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. As of March 31, 2011, the appraised values of the underlying collateral for our collateral-dependent impaired loans which had a related specific allowance or prior charge-off was in excess of the total fair value by \$12,107,000.

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

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 March 31, 2011	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	\$ 31,389	\$ -	\$ 31,389	\$ -
Mortgage backed securities:				
Government sponsored agencies	146,226	-	146,226	-
Nongovernment sponsored agencies	52,540	-	52,540	-
State and political subdivisions	22,168	-	22,168	-
Corporate debt securities	965	-	965	-
Other equity securities	77	-	77	-
Tax-exempt state and political subdivisions	39,875	-	39,875	-
Total available for sale securities	\$ 293,240	\$ -	\$ 293,240	\$ -

Dollars in thousands	Balance at December 31, 2010	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	\$ 30,665	\$ -	\$ 30,665	\$ -
Mortgage backed securities:				
Government sponsored agencies	123,037	-	123,037	-
Nongovernment sponsored agencies	59,267	-	59,267	-
State and political subdivisions	22,388	-	22,388	-
Corporate debt securities	949	-	949	-
Other equity securities	77	-	77	-
Tax-exempt state and political subdivisions	35,347	-	35,347	-
Total available for sale securities	\$ 271,730	\$ -	\$ 271,730	\$ -

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended March 31, 2011.

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.

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

Dollars in thousands	Total at March 31, 2011	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 402	\$ -	\$ 402	\$ -
Impaired loans				
Commercial	\$ 1,423	\$ -	\$ -	\$ 1,423
Commercial real estate	16,512	-	14,137	2,375
Construction and development	19,790	-	10,023	9,767
Residential real estate	20,755	-	16,608	4,147
Total impaired loans	\$ 58,480	\$ -	\$ 40,768	\$ 17,712
OREO	\$ 66,961	\$ -	\$ 66,961	\$ -

Dollars in thousands	Total at December 31, 2010	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 343	\$ -	\$ 343	\$ -
Impaired loans				
Commercial	\$ 630	\$ -	\$ -	\$ 630
Commercial real estate	16,408	-	13,569	2,839
Construction and development	13,940	-	11,251	2,689
Residential real estate	21,028	-	14,836	6,192
Total impaired loans	\$ 52,006	\$ -	\$ 39,656	\$ 12,350
OREO	\$ 70,235	\$ -	\$ 69,855	\$ 380

Impaired loans, which are measured for impairment primarily using the fair value of the collateral for collateral-dependent loans, had a carrying amount at March 31, 2011 of \$61,748,000, with a valuation allowance of \$3,268,000, resulting in no additional provision for loan losses for the three months ended March 31, 2011.

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.

Summit Financial Group, Inc. and Subsidiaries
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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.

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

Dollars in thousands	March 31, 2011		December 31, 2010	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets				
Cash and due from banks	\$ 4,263	\$ 4,263	\$ 4,652	\$ 4,652
Interest bearing deposits with				
other banks	46,448	46,448	45,696	45,696
Securities available for sale	293,240	293,240	271,730	271,730
Other investments	21,956	21,956	22,941	22,941
Loans held for sale, net	402	402	343	343
Loans, net	979,387	987,922	995,319	1,002,889
Accrued interest receivable	5,797	5,797	5,879	5,879

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	\$ 1,351,493	\$ 1,360,028	\$ 1,346,560	\$ 1,354,130
Financial liabilities				
Deposits	\$ 1,062,119	\$ 1,121,890	\$ 1,036,939	\$ 1,102,131
Short-term borrowings	1,879	1,879	1,582	1,582
Long-term borrowings	283,516	300,538	304,109	323,803
Subordinated debentures	16,800	16,800	16,800	16,800
Subordinated debentures owed to				
unconsolidated				
subsidiary trusts	19,589	19,589	19,589	19,589
Accrued interest payable	2,916	2,916	3,130	3,130
	\$ 1,386,819	\$ 1,463,612	\$ 1,382,149	\$ 1,467,035

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NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

Dollars in thousands, except per share amounts	For the Three Months Ended March 31,					
	2011	Common			2010	
	Income	Shares	Per	Income	Shares	Per
	(Numerator)	(Denominator)	Share	(Numerator)	(Denominator)	Share
Net income	\$ (248)			\$ 120		
Less preferred stock dividends	(74)			(74)		
Basic EPS	\$ (322)	7,425,472	\$ (0.04)	\$ 46	7,425,472	\$ 0.01
Effect of dilutive securities:						
Stock options	-	-		-	-	
Convertible preferred stock	-	-		-	-	
Diluted EPS	\$ (322)	7,425,472	\$ (0.04)	\$ 46	7,425,472	\$ 0.01

Stock option grants and the conversion of preferred stock are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options at March 31, 2011 and 2010 totaled 312,180 shares and 309,180 shares, respectively. Our anti-dilutive convertible preferred shares totaled 674,545 shares at March 31, 2011 and 2010.

NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at March 31, 2011, December 31, 2010, and March 31, 2010 are summarized as follows:

Dollars in thousands	Amortized Cost	March 31, 2011		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities:				
U. S. Government agencies				

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and corporations	\$ 31,530	\$ 217	\$ 358	\$ 31,389
Residential mortgage-backed securities:				
Government-sponsored agencies	143,883	2,751	408	146,226
Nongovernment-sponsored agencies	52,516	1,890	1,866	52,540
State and political subdivisions	23,324	21	1,177	22,168
Corporate debt securities	999	-	34	965
Total taxable debt securities	252,252	4,879	3,843	253,288
Tax-exempt debt securities:				
State and political subdivisions	40,238	273	636	39,875
Total tax-exempt debt securities	40,238	273	636	39,875
Equity securities	77	-	-	77
Total available for sale securities	\$ 292,567	\$ 5,152	\$ 4,479	\$ 293,240

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Dollars in thousands	Amortized Cost	December 31, 2010		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities				
U. S. Government agencies and corporations	\$ 30,645	\$ 319	\$ 299	\$ 30,665
Residential mortgage-backed securities:				
Government-sponsored agencies	119,608	3,642	213	123,037
Nongovernment-sponsored entities	60,257	2,528	3,518	59,267
State and political subdivisions	23,342	6	960	22,388
Corporate debt securities	999	-	50	949
Total taxable debt securities	234,851	6,495	5,040	236,306
Tax-exempt debt securities				
State and political subdivisions	35,843	211	707	35,347
Total tax-exempt debt securities	35,843	211	707	35,347
Equity securities	77	-	-	77
Total available for sale securities	\$ 270,771	\$ 6,706	\$ 5,747	\$ 271,730

Dollars in thousands	Amortized Cost	March 31, 2010		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities:				
U. S. Government agencies and corporations	\$ 53,229	\$ 679	\$ 108	\$ 53,800
Residential mortgage-backed securities:				
Government-sponsored agencies	94,777	4,365	74	99,068
Nongovernment-sponsored agencies	69,869	713	7,292	63,290
State and political subdivisions	4,280	38	17	4,301
Corporate debt securities	350	2	-	352
Total taxable debt securities	222,505	5,797	7,491	220,811
Tax-exempt debt securities:				
State and political subdivisions	41,613	480	416	41,677
Total tax-exempt debt securities	41,613	480	416	41,677
Equity securities	77	-	-	77
Total available for sale securities	\$ 264,195	\$ 6,277	\$ 7,907	\$ 262,565

The maturities, amortized cost and estimated fair values of securities at March 31, 2011, are summarized as follows:

Dollars in thousands	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 75,551	\$ 77,327
Due from one to five years	107,837	109,597
Due from five to ten years	34,156	33,641
Due after ten years	74,946	72,598
Equity securities	77	77
	\$ 292,567	\$ 293,240

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The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the three months ended March 31, 2011 are as follows:

Dollars in thousands	Sales	Proceeds from Calls and Maturities	Principal Payments	Gains	Gross realized Losses
Securities available for sale	\$ 13,256	\$ 2,889	\$ 17,311	\$ 1,633	\$ 5

During the three months ended March 31, 2011, we recorded other-than-temporary impairment losses on securities as follows:

Dollars in thousands	Three Months Ended			
	Residential MBS Nongovernment	Sponsored Entities	Equity Securities	Total
March 31, 2011				
Total other-than-temporary impairment losses	\$ (1,828)	\$ -	\$ -	\$ (1,828)
Portion of loss recognized in other comprehensive income	600	-	-	600
Net impairment losses recognized in earnings	\$ (1,228)	\$ -	\$ -	\$ (1,228)
March 31, 2010				
Total other-than-temporary impairment losses	\$ (454)	\$ -	\$ -	\$ (454)
Portion of loss recognized in other comprehensive income	425	-	-	425
Net impairment losses recognized in earnings	\$ (29)	\$ -	\$ -	\$ (29)

Activity related to the credit component recognized on debt securities available for sale for which a portion of other-than-temporary impairment was recognized in other comprehensive income for the three months ended March 31, 2011 is as follows:

Three
Months
Ended
March 31,
2011

Dollars in thousands	Total
Beginning Balance	\$ (3,910)
Additions for the credit component on debt securities in which other-than-temporary impairment was not previously recognized	(1,228)
Securities sold during the period	-
Ending Balance	\$ (5,138)

At March 31, 2011, our debt securities with other-than-temporary impairment in which only the amount of loss related to credit was recognized in earnings consisted solely of residential mortgage-backed securities issued by nongovernment-sponsored entities. We utilize third party vendors to estimate the portion of loss attributable to credit using a discounted cash flow models. The vendors estimate cash flows of the underlying collateral of each mortgage-backed security using models that incorporate their best estimates of current key assumptions, such as default rates, loss severity and prepayment rates. Assumptions utilized vary widely from security to security, and are influenced by such factors as underlying loan interest rates, geographical location of underlying borrowers, collateral type and other borrower characteristics. Specific such assumptions utilized by our vendors in their valuation of our other-than-temporarily impaired residential mortgage-backed securities issued by nongovernment-sponsored entities were as follows at March 31, 2011:

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	Weighted Average	Range Minimum Maximum	
Constant voluntary prepayment rates	12.0%	5.4%	17.6%
Constant default rates	6.7%	3.5%	10.2%
Loss severities	49.0%	40.0%	56.0%

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

Provided below is a summary of securities available for sale which were in an unrealized loss position at March 31, 2011 and December 31, 2010, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

Dollars in thousands	Less than 12 months		March 31, 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	\$ 16,953	\$ (344)	\$ 1,259	\$ (14)	\$ 18,212	\$ (358)
Residential						
mortgage-backed securities:						
Government-sponsored						
agencies	41,034	(408)	-	-	41,034	(408)
Nongovernment-sponsored						
entities	1,304	(13)	9,829	(795)	11,133	(808)
State and political						
subdivisions	17,107	(1,172)	385	(5)	17,492	(1,177)
Corporate debt securities	965	(34)	-	-	965	(34)
Tax-exempt debt securities						
State and political						
subdivisions	20,170	(476)	1,161	(160)	21,331	(636)
Total temporarily impaired						
securities	97,533	(2,447)	12,634	(974)	110,167	(3,421)

Other-than-temporarily
impaired securities

Taxable debt securities						
Residential mortgage-backed securities:						
Nongovernment-sponsored entities						
	474	(624)	3,460	(434)	3,934	(1,058)
Total other-than-temporarily impaired securities						
	474	(624)	3,460	(434)	3,934	(1,058)
Total	\$ 98,007	\$ (3,071)	\$ 16,094	\$ (1,408)	\$ 114,101	\$ (4,479)

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Summit Financial Group, Inc. and Subsidiaries
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Dollars in thousands	Less than 12 months		December 31, 2010 12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$ 9,658	\$ (284)	\$ 1,272	\$ (15)	\$ 10,930	\$ (299)
Residential						
mortgage-backed securities:						
Government-sponsored						
agencies	24,869	(213)	-	-	24,869	(213)
Nongovernment-sponsored						
entities	7,506	(459)	12,695	(2,716)	20,201	(3,175)
State and political						
subdivisions	18,215	(955)	385	(5)	18,600	(960)
Corporate debt securities	949	(50)	-	-	949	(50)
Tax-exempt debt securities						
State and political						
subdivisions	17,523	(555)	1,169	(152)	18,692	(707)
Total temporarily impaired						
securities	78,720	(2,516)	15,521	(2,888)	94,241	(5,404)
Other-than-temporarily						
impaired securities						
Taxable debt securities						
Residential						
mortgage-backed securities:						
Nongovernment-sponsored						
entities	71	(43)	4,624	(300)	4,695	(343)
Total other-than-temporarily						
impaired securities	71	(43)	4,624	(300)	4,695	(343)
Total	\$ 78,791	\$ (2,559)	\$ 20,145	\$ (3,188)	\$ 98,936	\$ (5,747)

We held 102 available for sale securities, including debt securities with other-than-temporary impairment in which a portion of the impairment remains in other comprehensive income, having an unrealized loss at March 31, 2011. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no additional other-than-temporary impairment charge to earnings is warranted at this time.

At March 31, 2011, we had \$1.9 million in total unrealized losses related to residential mortgage-backed securities issued by nongovernment sponsored entities. We monitor the performance of the mortgages underlying these bonds. Although there has been some deterioration in their collateral performance, we primarily hold the senior tranches of each issue which provides protection against defaults. We attribute the unrealized loss on these

mortgage-backed securities held largely to the current absence of liquidity in the markets for such securities. 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.

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

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

Loans are summarized as follows:

Dollars in thousands	March 31, 2011	December 31, 2010	March 31, 2010
Commercial	\$ 92,227	\$ 97,059	\$ 121,258
Commercial real estate			
Owner-occupied	182,956	187,098	198,974
Non-owner occupied	240,604	235,337	256,420
Construction and development			
Land and land development	93,675	99,085	109,381
Construction	13,879	13,691	41,808
Residential real estate			
Non-jumbo	233,308	239,290	252,413
Jumbo	61,878	61,340	66,862
Home equity	50,499	50,987	50,654
Consumer	22,968	24,145	27,303
Other	4,326	4,511	5,296
Total loans, net of unearned fees	996,320	1,012,543	1,130,369
Less allowance for loan losses	16,933	17,224	17,843
Loans, net	\$ 979,387	\$ 995,319	\$ 1,112,526

The following table presents the contractual aging of the recorded investment in past due loans by class as of March 31, 2011 and 2010 and December 31, 2010.

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At March 31, 2011

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

At December 31, 2010

Dollars in thousands	Past Due			Total	Current	Recorded Investment > 90 days and Accruing
	30-59 days	60-89 days	> 90 days			
Commercial	\$ 388	\$ 307	\$ 1,286	\$ 1,981	\$ 95,078	\$ -
Commercial real estate						
Owner-occupied	364	-	1,348	1,712	185,386	-
Non-owner occupied	3,697	590	310	4,597	230,740	-
Construction and development						
	3,023	131	9,732	12,886	86,199	-

Land and land development						
Construction	-	2	317	319	13,372	-
Residential mortgage						
Non-jumbo	3,557	2,412	3,953	9,922	229,368	-
Jumbo	2,997	10,383	2,549	15,929	45,411	1,442
Home equity	501	270	51	822	50,165	-
Consumer	420	147	107	674	23,471	-
Other	9	10	-	19	4,492	-
Total	\$ 14,956	\$ 14,252	\$ 19,653	\$ 48,861	\$ 963,682	\$ 1,442

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At March 31, 2010

Dollars in thousands	Past Due			Total	Current	Recorded Investment > 90 days and Accruing
	30-59 days	60-89 days	> 90 days			
Commercial	\$ 155	\$ 1,084	\$ 469	\$ 1,708	\$ 119,550	\$ -
Commercial real estate						
Owner-occupied	-	1,099	309	1,408	197,567	-
Non-owner occupied	2,203	6,701	33,000	41,904	214,516	-
Construction and development						
Land and land development	10,039	1,568	10,277	21,884	87,496	-
Construction	-	45	6,393	6,438	35,370	-
Residential mortgage						
Non-jumbo	5,214	1,072	2,765	9,051	243,243	-
Jumbo	927	655	627	2,209	64,772	-
Home equity	961	-	432	1,393	49,262	167
Consumer	293	132	190	615	26,687	3
Other	10	3	-	13	5,283	-
Total	\$ 19,802	\$ 12,359	\$ 54,462	\$ 86,623	\$ 1,043,746	\$ 170

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at March 31, 2011, December 31, 2010 and March 31, 2010.

Dollars in thousands	3/31/2011	12/31/2010	3/31/2010
Commercial	\$ 2,186	\$ 1,318	\$ 511
Commercial real estate			
Owner-occupied	3,785	2,372	312
Non-owner occupied	1,499	314	33,595
Construction and development			
Land & land development	8,358	9,732	10,279
Construction	201	317	6,407
Residential mortgage			
Non-jumbo	4,908	4,918	3,083
Jumbo	927	1,106	631
Home equity	508	51	339

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Consumer	197	141	206
Other	-	-	-
Total	\$ 22,569	\$ 20,269	\$ 55,363

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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.

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 tables below set forth information about our impaired loans.

Method Used to Measure Impairment of Impaired Loans				Method used to measure impairment
Loan Category	03/31/2011	12/31/2010	03/31/2010	
Commerical	\$ 1,436	\$ 630	\$ 517	Fair value of collateral
Commerical real estate				
Owner-occupied	8,393	8,866	7,311	Fair value of collateral
	2,618	2,623	2,398	Discounted cash flow
Non-owner occupied	4,455	4,922	39,581	Fair value of collateral
	530	530	1,951	Discounted cash flow
Construction and development				
Land & land development	22,130	16,515	20,567	Fair value of collateral
Construction	92	-	5,974	

				Fair value of collateral
Residential mortgage				
Non-jumbo	5,906	4,533	2,257	Fair value of collateral
	577	753	29	Discounted cash flow
Jumbo	15,401	17,296	2,593	Fair value of collateral
Home equity	210	213	-	Fair value of collateral
Total	\$ 61,748	\$ 56,881	\$ 83,178	

The following tables present loans individually evaluated for impairment at March 31, 2011, December 31, 2010 and March 31, 2010.

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	March 31, 2011				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 1,422	\$ 1,423	\$ -	\$ 215	\$ 1
Commercial real estate					
Owner-occupied	7,049	7,068	-	1,761	12
Non-owner occupied	1,637	1,638	-	728	8
Construction and development					
Land & land development					
Land & land development	19,217	19,217	-	5,417	16
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	4,055	4,077	-	2,439	19
Jumbo	13,128	13,129	-	4,376	75
Home equity	-	-	-	-	-
Total without a related allowance	\$ 46,508	\$ 46,552	\$ -	\$ 14,936	\$ 131
With a related allowance					
Commercial	\$ 14	\$ 14	\$ 14	\$ -	\$ -
Commercial real estate					
Owner-occupied	3,943	3,943	280	2,198	12
Non-owner occupied	3,341	3,347	470	721	7
Construction and development					
Land & land development					
Land & land development	2,912	2,912	1,160	2,352	3
Construction	92	92	5	1	-
Residential real estate					
Non-jumbo	2,404	2,406	681	718	6
Jumbo	2,272	2,272	448	757	-
Home equity	210	210	210	178	-
Total with a related allowance	\$ 15,188	\$ 15,196	\$ 3,268	\$ 6,925	\$ 28
Total					
Commercial	\$ 39,627	\$ 39,654	\$ 1,929	\$ 13,393	\$ 59
Residential real estate	22,069	22,094	1,339	8,468	100
Total	\$ 61,696	\$ 61,748	\$ 3,268	\$ 21,861	\$ 159

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

	December 31, 2010				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 629	\$ 630	\$ -	\$ 232	\$ 9
Commercial real estate					
Owner-occupied	7,538	7,556	-	9,052	440
Non-owner occupied	3,314	3,321	-	12,852	734
Construction and development					
Land & land development	9,213	9,214	-	12,852	468
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	2,161	2,696	-	2,074	76
Jumbo	14,822	14,822	-	7,887	547
Home equity	165	165	-	-	-
Total without a related allowance	\$ 37,842	\$ 38,404	\$ -	\$ 44,949	\$ 2,274
With a related allowance					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate					
Owner-occupied	3,933	3,933	265	670	-
Non-owner occupied	2,130	2,130	267	1,953	88
Construction and development					
Land & land development	7,301	7,301	2,575	3,183	7
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	2,589	2,591	843	1,242	22
Jumbo	2,474	2,474	877	1,343	31
Home equity	48	48	48	12	1
Total with a related allowance	\$ 18,475	\$ 18,477	\$ 4,875	\$ 8,403	\$ 149
Total					
Commercial	\$ 34,058	\$ 34,085	\$ 3,107	\$ 40,794	\$ 1,746
Residential real estate	22,259	22,796	1,768	12,558	677
Total	\$ 56,317	\$ 56,881	\$ 4,875	\$ 53,352	\$ 2,423

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	March 31, 2010				
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 348	\$ 348	\$ -	\$ 34	\$ -
Commercial real estate					
Owner-occupied	9,666	9,710	-	8,622	140
Non-owner occupied	5,776	5,796	-	5,277	52
Construction and development					
Land & land development					
Land & land development	11,192	11,193	-	4,840	1
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	2,266	2,281	-	965	4
Jumbo	1,583	1,582	-	18	-
Home equity	-	-	-	-	-
Consumer	-	-	-	-	-
Total without a related allowance	\$ 30,831	\$ 30,910	\$ -	\$ 19,756	\$ 197
With a related allowance					
Commercial	\$ 170	\$ 169	\$ 122	\$ 169	\$ -
Commercial real estate					
Owner-occupied	-	-	-	-	-
Non-owner occupied	35,678	35,736	6,122	35,240	50
Construction and development					
Land & land development					
Land & land development	9,374	9,374	2,578	9,374	65
Construction	5,961	5,974	913	5,974	-
Residential real estate					
Non-jumbo	383	384	384	384	6
Jumbo	627	631	325	631	-
Home equity	-	-	-	-	-
Total with a related allowance	\$ 52,193	\$ 52,268	\$ 10,444	\$ 51,772	\$ 121
Total					
Commercial	\$ 78,165	\$ 78,300	\$ 9,735	\$ 69,530	\$ 308
Consumer	-	-	-	-	-

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Residential	4,859	4,878	709	1,998	10
Total	\$ 83,024	\$ 83,178	\$ 10,444	\$ 71,528	\$ 318

Included in impaired loans are troubled debt restructurings of \$31,427,000 and \$31,712,000 at March 31, 2011 and December 31, 2010, respectively, with no commitments to lend additional funds under these restructurings at either balance sheet date.

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:

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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	3/31/2011	12/31/2010	3/31/2011	12/31/2010	3/31/2011	12/31/2010	3/31/2011	12/31/2010	3/31/2011	12/31/2010
Pass	\$60,697	\$63,061	\$13,579	\$13,321	\$84,524	\$89,129	\$162,168	\$167,048	\$218,857	\$218,555
OLEM (Special Mention)	19,326	19,509	249	249	5,765	6,481	9,059	4,417	18,219	14,154
Substandard	13,652	15,796	51	121	1,938	1,449	11,729	15,633	3,528	2,628
Doubtful	-	719	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-	-	-
Total	\$93,675	\$99,085	\$13,879	\$13,691	\$92,227	\$97,059	\$182,956	\$187,098	\$240,604	\$235,337

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

Dollars in thousands	Performing			Nonperforming		
	3/31/2011	12/31/2010	3/31/2010	3/31/2011	12/31/2010	3/31/2010

Residential real estate						
Non-jumbo	\$ 228,400	\$ 233,857	\$ 249,211	\$ 4,908	\$ 5,433	\$ 3,083
Jumbo	60,951	59,307	66,350	927	2,033	631
Home Equity	49,991	50,936	50,149	508	51	506
Consumer	22,771	24,003	27,093	197	142	209
Other	4,326	4,511	5,296	-	-	-
Total	\$ 366,439	\$ 372,614	\$ 398,099	\$ 6,540	\$ 7,659	\$ 4,429

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.

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NOTE 7. ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses for the three month periods ended March 30, 2011 and 2010, and for the year ended December 31, 2010 is as follows:

	Three Months Ended		Year
	March 31,		Ended
Dollars in thousands	2011	2010	December
			31,
			2010
Balance, beginning of period	\$ 17,224	\$ 17,000	\$ 17,000
Losses:			
Commercial			