

SUMMIT FINANCIAL GROUP INC
Form 10-K
March 01, 2012

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

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
(I.R.S. Employer
Identification No.)

300 N. Main Street
Moorefield, West Virginia
(Address of principal executive offices)

26836
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Common
(Title of Class)

The NASDAQ Capital Market
(Name of Exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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 Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K.

Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions 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 (Do not check if a smaller reporting company) Smaller reporting company

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant at June 30, 2011, was approximately \$17,179,000. Registrant has assumed that all of its executive officers and directors are affiliates. Such assumption shall not be deemed to be conclusive for any other purpose.

The number of shares of the Registrant’s Common Stock outstanding on February 29, 2012, was 7,425,472.

Documents Incorporated by Reference

The following lists the documents which are incorporated by reference in the Annual Report Form 10-K, and the Parts and Items of the Form 10-K into which the documents are incorporated.

Document	Part of Form 10-K into which document is incorporated
Portions of the Registrant’s Proxy Statement for the III - Items 10, 11, 12, 13, and 14 Annual Meeting of Shareholders to be held May 17, 2012	Part

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PART I.

Item 1. Business

Summit Financial Group, Inc. (“Company” or “Summit”) is a \$1.45 billion financial holding company headquartered in Moorefield, West Virginia. We provide community banking services primarily in the Eastern Panhandle and South Central regions of West Virginia and the Northern region of Virginia. We provide these services through our community bank subsidiary, Summit Community Bank (“Summit Community” or “Bank”). We also operate Summit Insurance Services, LLC in Moorefield, West Virginia and Leesburg, Virginia.

Community Banking

We provide a wide range of community banking services, including demand, savings and time deposits; commercial, real estate and consumer loans; letters of credit; and cash management services. The deposits of Summit Community are insured by the Federal Deposit Insurance Corporation (“FDIC”).

In order to compete with other financial service providers, we principally rely upon personal relationships established by our officers, directors and employees with our clients, and specialized services tailored to meet our clients’ needs. We have maintained a strong community orientation by, among other things, supporting the active participation of staff members in local charitable, civic, school, religious and community development activities. We also have a marketing program that primarily utilizes local radio and newspapers to advertise. Banking, like most industries, is becoming more dependent on technology as a means of marketing to customers, including the internet, which we also utilize. This approach, coupled with continuity of service by the same staff members, enables Summit Community to develop long-term customer relationships, maintain high quality service and respond quickly to customer needs. We believe that our emphasis on local relationship banking, together with a prudent approach to lending, are important factors in our success and growth.

All operational and support functions that are transparent to clients are centralized in order to achieve consistency and cost efficiencies in the delivery of products and services by each banking office. The central office provides services such as data processing, bookkeeping, accounting, treasury management, loan administration, loan review, compliance, risk management and internal auditing to enhance our delivery of quality service. We also provide overall direction in the areas of credit policy and administration, strategic planning, marketing, investment portfolio management and other financial and administrative services. The banking offices work closely with us to develop new products and services needed by their customers and to introduce enhancements to existing products and services.

Lending

Our primary lending focus is providing commercial loans to local businesses with annual sales ranging from \$300,000 to \$30 million and providing owner-occupied real estate loans to individuals. Typically, our customers have financing requirements between \$50,000 and \$1,000,000. We generally do not seek loans of more than \$5 million but will consider larger lending relationships which involve exceptional levels of credit quality. Under our commercial banking strategy, we focus on offering a broad line of financial products and services to small and medium-sized businesses through full service banking offices. Summit Community Bank has senior management with extensive lending experience. These managers exercise substantial authority over credit and pricing decisions, subject to loan committee approval for larger credits.

We segment our loan portfolio in to the following major lending categories: commercial, commercial real estate, construction and development, residential real estate, and consumer. Commercial loans are loans made to commercial borrowers that are not secured by real estate. These encompass loans secured by accounts receivable, inventory,

equipment, as well as unsecured loans. Commercial real estate loans consist of commercial mortgages, which generally are secured by nonresidential and multi-family residential properties. Commercial real estate loans are made to many of the same customers and carry similar industry risks as the commercial loan portfolio. Construction and development loans are loans made for the purpose of financing construction or development projects. This portfolio includes commercial and residential land development loans, one-to-four family housing construction both pre-sold and speculative in nature, multi-family housing construction, non-residential building construction, and undeveloped land. Residential real estate loans are mortgage loans to consumers and are secured primarily by a first lien deed of trust. These loans are traditional one-to-four family residential mortgages. Also included in this category of loans are second liens on one-to-four family properties as well as home equity loans. Consumer loans are loans that establish consumer credit that is granted for the consumer's personal use. These loans include automobile loans, recreational vehicle loans, as well as personal secured and unsecured loans.

Our loan underwriting guidelines and standards are consistent with the prudent banking practices applicable to the relevant exposure and are updated periodically and presented to the Board of Directors for approval. The purpose of these standards and guidelines are: to grant loans on a sound and collectible basis, to invest available funds in a safe and profitable manner, to serve the legitimate credit needs of our primary market area, and to ensure that all loan applicants receive fair and equal treatment in the lending process. It is the intent of the underwriting guidelines and standards to: minimize losses by carefully investigating the credit history of each applicant, verify the source of repayment and the ability of the applicant to repay, collateralize those loans in which collateral is deemed to be required, exercise care in the documentation of the application, review, approval, and origination process, and administer a comprehensive loan collection program.

Our real estate underwriting loan-to-value (“LTV”) policy limits are at or below current bank regulatory guidelines, as follows:

	Regulatory LTV Guideline	Summit LTV Policy Limit
Undeveloped land	65%	65%
Land development	75%	70%
Construction:		
Commercial, multifamily, and other non-residential	80%	80%
1-4 family residential, consumer borrower	85%	85%
1-4 family residential, commercial borrower	85%	80%
Improved property	85%	80%
Owner occupied 1-4 family	90%	85%
Home equity	90%	90%

Exceptions are permitted to these regulatory guidelines as long as such exceptions are identified, monitored, and reported to the Board of Directors at least quarterly, and the total of such exceptions do not exceed 100% of Summit Community’s total regulatory capital, which totaled \$142.3 million as of December 31, 2011. As of this date, we had loans approximating \$57.1 million that exceeded the above regulatory LTV guidelines, as follows:

Residential real estate	
Owner occupied – 1st lien	\$ 11.4 million

Owner occupied – 2nd lien	\$ 1.4 million
Commercial real estate	
Residential non-owner occupied, 1st lien	\$ 4.9 million
Owner occupied commercial real estate	\$ 21.6 million
Other commercial real estate	\$ 5.6 million
Construction, development & land	
	\$ 12.2 million

Our underwriting standards and practice are designed to originate both fixed and variable rate loan products consistent with the underwriting guidelines discussed above. Adjustable rate and variable rate loans are underwritten giving consideration both to the loan’s initial rate and to higher assumed rates commensurate with reasonably anticipated market conditions. Accordingly, we want to insure that adequate primary repayment capacity exists to address both future increases in interest rates, and fluctuations in the underlying cash flows available for repayment. Historically, we have not offered “teaser rates” or “payment option ARM” loans. Further, we have had no loan portfolio products which were specifically designed for “sub-prime” borrowers (defined as consumers with a credit score of less than 599).

Supervision and Regulation

General

We, as a financial holding company, are subject to the restrictions of the Bank Holding Company Act of 1956, as amended (“BHCA”), and are registered pursuant to its provisions. As a registered financial holding company, we are subject to the reporting requirements of the Board of Governors of the Federal Reserve System (“FRB”), and are subject to examination by the FRB. As a financial holding company doing business in West Virginia, we are also subject to regulation by the West Virginia Board of Banking and Financial Institutions and must submit annual reports to the West Virginia Division of Banking.

The BHCA prohibits the acquisition by a financial holding company of direct or indirect ownership of more than five percent of the voting shares of any bank within the United States without prior approval of the FRB. With certain exceptions, a financial holding company is prohibited from acquiring direct or indirect ownership or control or more than five percent of the voting shares of any company which is not a bank, and from engaging directly or indirectly in business unrelated to the business of banking or managing or controlling banks.

The FRB, in its Regulation Y, permits financial holding companies to engage in non-banking activities closely related to banking or managing or controlling banks. Approval of the FRB is necessary to engage in these activities or to make acquisitions of corporations engaging in these activities as the FRB determines whether these acquisitions or activities are in the public interest. In addition, by order, and on a case by case basis, the FRB may approve other non-banking activities.

The BHCA permits us to purchase or redeem our own securities. However, Regulation Y provides that prior notice must be given to the FRB if the total consideration for such purchase or redemption, when aggregated with the net consideration paid by us for all such purchases or redemptions during the preceding 12 months is equal to 10 percent or more of our consolidated net worth. Prior notice is not required if (i) both before and immediately after the redemption, the financial holding company is well-capitalized; (ii) the financial holding company is well-managed and (iii) the financial holding company is not the subject of any unresolved supervisory issues.

Federal law restricts subsidiary banks of a financial holding company from making certain extensions of credit to the parent financial holding company or to any of its subsidiaries, from investing in the holding company stock, and limits the ability of a subsidiary bank to take its parent company stock as collateral for the loans of any borrower. Additionally, federal law prohibits a financial holding company and its subsidiaries from engaging in certain tie--in arrangements in conjunction with the extension of credit or furnishing of services.

Summit Community is subject to West Virginia statutes and regulations, and is primarily regulated by the West Virginia Division of Banking and is also subject to regulations promulgated by the FRB and the FDIC. As members of the FDIC, the deposits of the bank are insured as required by federal law. Bank regulatory authorities regularly examine revenues, loans, investments, management practices, and other aspects of Summit Community. These examinations are conducted primarily to protect depositors and not shareholders. In addition to these regular examinations, Summit Community must furnish to regulatory authorities quarterly reports containing full and accurate statements of their affairs.

The FRB has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations. The FRB also can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as \$1 million for each day the activity continues.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

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

§ Centralize responsibility for consumer financial protection by creating a new agency, the Bureau of Consumer Financial Protection, responsible for implementing, examining and enforcing compliance with federal consumer financial laws.

- § Require the bank regulators to seek to make its capital requirements for all banks countercyclical so that capital requirements increase in times of economic expansion and decrease in times of economic contraction.
- § Require financial holding companies to be well-capitalized and well-managed as of July 21, 2011. Bank holding companies and banks must also be both well-capitalized and well-managed in order to acquire banks located outside their home state.

- § Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminate the ceiling on the size of the Deposit Insurance Fund (DIF) and increase the floor of the size of the DIF, which generally will require an increase in the level of assessments for institutions with assets in excess of \$10 billion.
- § Impose comprehensive regulation of the over-the-counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself.
- § Implement corporate governance revisions, including with regard to executive compensation and proxy access by shareholders that apply to all public companies, not just financial institutions.
- § Make permanent the \$250 thousand limit for federal deposit insurance and provide unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions.
- § Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.
- § Amend the Electronic Fund Transfer Act (EFTA) to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

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

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. Under the new restoration plan, the FDIC will update its loss and income projections at least semi-annually for the fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required.

In November 2010, the FDIC issued a final rule to implement provisions of the Dodd-Frank Act that provide for temporary unlimited coverage for non-interest-bearing transaction accounts. The separate coverage for non-interest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012.

In April 2011, the FDIC implemented rulemaking under the Dodd-Frank Act to reform the deposit insurance assessment system. The final rule redefined the assessment base used for calculating deposit insurance assessments. Specifically, the rule bases assessments on an institution's total assets less tangible capital, as opposed to total deposits. Since the new base is larger than the prior base, the FDIC also proposed lowering assessment rates so that the rules would not significantly alter the total amount of revenue collected from the industry. The new assessment scale ranges from 2.5 basis points for the least risky institutions to 45 basis points for the riskiest.

Permitted Non-banking Activities

The FRB permits, within prescribed limits, financial holding companies to engage in non-banking activities closely related to banking or to managing or controlling banks. Such activities are not limited to the state of West Virginia. Some examples of non-banking activities which presently may be performed by a financial holding company are: making or acquiring, for its own account or the account of others, loans and other extensions of credit; operating as an industrial bank, or industrial loan company, in the manner authorized by state law; servicing loans and other extensions of credit; performing or carrying on any one or more of the functions or activities that may be performed or carried on by a trust company in the manner authorized by federal or state law; acting as an investment or financial advisor; leasing real or personal property; making equity or debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and the development of low income areas; providing bookkeeping services or financially oriented data processing services for the holding

company and its subsidiaries; acting as an insurance agent or a broker; acting as an underwriter for credit life insurance which is directly related to extensions of credit by the financial holding company system; providing courier services for certain financial documents; providing management consulting advice to nonaffiliated banks; selling retail money orders having a face value of not more than \$1,000, traveler's checks and U.S. savings bonds; performing appraisals of real estate; arranging commercial real estate equity financing under certain limited circumstances; providing securities brokerage services related to securities credit activities; underwriting and dealing in government obligations and money market instruments; providing foreign exchange advisory and transactional services; and acting under certain circumstances, as futures commission merchant for nonaffiliated persons in the execution and clearance on major commodity exchanges of futures contracts and options.

Credit and Monetary Policies and Related Matters

Summit Community is affected by the fiscal and monetary policies of the federal government and its agencies, including the FRB. An important function of these policies is to curb inflation and control recessions through control of the supply of money and credit. The operations of Summit Community are affected by the policies of government regulatory authorities, including the FRB which regulates money and credit conditions through open market operations in United States Government and Federal agency securities, adjustments in the discount rate on member bank borrowings, and requirements against deposits and regulation of interest rates payable by member banks on time and savings deposits. These policies have a significant influence on the growth and distribution of loans, investments and deposits, and interest rates charged on loans, or paid for time and savings deposits, as well as yields on investments. The FRB has had a significant effect on the operating results of commercial banks in the past and is expected to continue to do so in the future. Future policies of the FRB and other authorities and their effect on future earnings cannot be predicted.

The FRB has a policy that a financial holding company is expected to act as a source of financial and managerial strength to each of its subsidiary banks and to commit resources to support each such subsidiary bank. Under the source of strength doctrine, the FRB may require a financial holding company to contribute capital to a troubled subsidiary bank, and may charge the financial holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. This capital injection may be required at times when Summit may not have the resources to provide it. Any capital loans by a holding company to any subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In addition, the Crime Control Act of 1990 provides that in the event of a financial holding company's bankruptcy, any commitment by such holding company to a Federal bank or thrift regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

The Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") provides that depository institutions insured by the FDIC may be liable for any losses incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution, or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. "Default" is defined generally as the appointment of a conservator or receiver and "in danger of default" is defined generally as the existence of certain conditions indicating that a "default" is likely to occur in the absence of regulatory assistance. Accordingly, in the event that any insured bank or subsidiary of Summit causes a loss to the FDIC, other bank subsidiaries of Summit could be liable to the FDIC for the amount of such loss.

Under federal law, the OCC may order the pro rata assessment of shareholders of a national bank whose capital stock has become impaired, by losses or otherwise, to relieve a deficiency in such national bank's capital stock. This statute also provides for the enforcement of any such pro rata assessment of shareholders of such national bank to cover such impairment of capital stock by sale, to the extent necessary, of the capital stock of any assessed shareholder failing to pay the assessment. Similarly, the laws of certain states provide for such assessment and sale with respect to the

subsidiary banks chartered by such states. Summit, as the sole stockholder of Summit Community, is subject to such provisions.

Capital Requirements

As a financial holding company, we are subject to FRB risk-based capital guidelines. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations, takes off-balance sheet exposures into explicit account in assessing capital adequacy, and minimizes disincentives to holding liquid, low-risk assets. Under the guidelines and related policies, financial holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance sheet commitments into four weighted categories, with higher levels of capital being required for categories perceived as representing greater risk. Summit Community is subject to substantially similar capital requirements adopted by its applicable regulatory agencies.

Generally, under the applicable guidelines, a financial institution's capital is divided into two tiers. "Tier 1", or core capital, includes common equity, noncumulative perpetual preferred stock (including related surplus) and minority interests in equity accounts of consolidated subsidiaries, less goodwill and other intangibles. "Tier 2", or supplementary capital, includes, among other things, cumulative and limited-life preferred stock, hybrid capital instruments, mandatory convertible securities, qualifying subordinated debt, and the allowance for loan losses, subject to certain limitations, less required deductions. "Total capital" is the sum of Tier 1 and Tier 2 capital. Financial holding companies are subject to substantially identical requirements, except that cumulative perpetual preferred stock can constitute up to 25% of a financial holding company's Tier 1 capital.

Financial holding companies are required to maintain a risk-based capital ratio of 8%, of which at least 4% must be Tier 1 capital. The appropriate regulatory authority may set higher capital requirements when an institution's particular circumstances warrant. For purposes of the leverage ratio, the numerator is defined as Tier 1 capital and the denominator is defined as adjusted total assets (as specified in the guidelines). The guidelines provide for a minimum leverage ratio of 4% for financial holding companies that meet certain specified criteria, including excellent asset quality, high liquidity, low interest rate exposure and the highest regulatory rating. Financial holding companies not meeting these criteria are required to maintain a leverage ratio which exceeds 4% by a cushion of at least 1 to 2 percent.

The guidelines also provide that financial holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. Furthermore, the FRB's guidelines indicate that the FRB will continue to consider a "tangible Tier 1 leverage ratio" in evaluating proposals for expansion or new activities. The tangible Tier 1 leverage ratio is the ratio of an institution's Tier 1 capital, less all intangibles, to total assets, less all intangibles.

Section 305 of FDICIA (as defined below) required the FRB and other banking agencies to revise their risk-based capital standards to ensure that those standards take adequate account of interest rate risk. This final rule amends the capital standards to specify that the banking agencies include, in their evaluations of a bank's capital adequacy, an assessment of the exposure to declines in the economic value of the bank's capital due to changes in interest rates.

Failure to meet applicable capital guidelines could subject the financial holding company to a variety of enforcement remedies available to the federal regulatory authorities, including limitations on the ability to pay dividends, the issuance by the regulatory authority of a capital directive to increase capital and termination of deposit insurance by the FDIC, as well as to the measures described under the "Federal Deposit Insurance Corporation Improvement Act of 1991" as applicable to undercapitalized institutions.

Our regulatory capital ratios and Summit Community's capital ratios as of year end 2011 are set forth in the table in Note 16 of the notes to the consolidated financial statements on page 81.

Basel III Standards. In December 2010, the Basel Committee on Banking Supervision ("Basel Committee") released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III." Basel III, when implemented by the U.S. bank regulatory agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity. The Basel III final capital framework, among other things:

§ introduces as a new capital measure Common Equity Tier 1 ("CET1"), specifies that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, defines CET1 narrowly by requiring that most deductions or adjustments to regulatory capital measures be made to CET1 and not to the other components of

capital, and expands the scope of the deductions or adjustments as compared to existing regulations;

§ when fully phased in on January 1, 2019, requires banks to maintain:

- o as a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%);

- o a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation);
- o a minimum ratio of Total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation);
- o as a newly adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (as the average for each quarter of the month-end ratios for the quarter); and
- o provides for a “countercyclical capital buffer”, generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk, that would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented (potentially resulting in total buffers of between 2.5% and 5%).

The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The implementation of the Basel III final framework will commence January 1, 2013. On that date, banking institutions will be required to meet the following minimum capital ratios before the application of any buffer:

§ 3.5% CET1 to risk-weighted assets;

§ 4.5% Tier 1 capital to risk-weighted assets; and

§ 8.0% Total capital to risk-weighted assets.

The Basel III final framework provides for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2014 and will be phased-in over a five-year period (20% per year). The implementation of the capital conservation buffer will begin on January 1, 2016 at 0.625% and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

The U.S. banking agencies have indicated informally that they expect to propose regulations implementing Basel III during the first quarter of 2012 and final rules later in 2012. Notwithstanding its release of the Basel III framework as a final framework, the Basel Committee is considering further amendments to Basel III, including the imposition of additional capital surcharges on globally systemically important financial institutions. In addition to Basel III, the

Dodd-Frank Act requires or permits the Federal banking agencies to adopt regulations affecting banking institutions' capital requirements in a number of respects, including potentially more stringent capital requirements for systemically important financial institutions. On November 22, 2011, the FRB issued a final rule requiring top-tier U.S. bank holding companies with total consolidated assets of \$50 billion or more to submit annual capital plans for review. In addition, the FRB also expects these banks to demonstrate that they can achieve the capital ratios required by the Basel III framework as applied to the U.S. Accordingly, the regulations ultimately applicable to us may be substantially different from the Basel III final framework as published in December 2010 and redefined in 2011.

Liquidity Ratios under Basel III. Historically, regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, both in the U.S. and internationally, without required formulaic measures. The Basel III final framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks

and regulators for management and supervisory purposes, going forward will be required by regulation. One test, referred to as the liquidity coverage ratio ("LCR"), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other, referred to as the net stable funding ratio ("NSFR"), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. The LCR would be implemented subject to an observation period beginning in 2011, but would not be introduced as a requirement until January 1, 2015, and the NSFR would not be introduced as a requirement until January 1, 2018. These new standards are subject to further rulemaking and their terms may well change before implementation.

Federal Deposit Insurance Corporation Improvement Act of 1991

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") substantially revised the bank regulatory and funding provisions of the Federal Deposit Insurance Corporation Act and made revisions to several other banking statutes.

FDICIA establishes a new regulatory scheme, which ties the level of supervisory intervention by bank regulatory authorities primarily to a depository institution's capital category. Among other things, FDICIA authorizes regulatory authorities to take "prompt corrective action" with respect to depository institutions that do not meet minimum capital requirements. FDICIA establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

By regulation, an institution is "well-capitalized" if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater and a Tier 1 leverage ratio of 5% or greater and is not subject to a regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure. Summit Community was a "well capitalized" institution as of December 31, 2011. Well-capitalized institutions are permitted to engage in a wider range of banking activities, including among other things, the accepting of "brokered deposits," and the offering of interest rates on deposits higher than the prevailing rate in their respective markets.

Another requirement of FDICIA is that Federal banking agencies must prescribe regulations relating to various operational areas of banks and financial holding companies. These include standards for internal audit systems, loan documentation, information systems, internal controls, credit underwriting, interest rate exposure, asset growth, compensation, a maximum ratio of classified assets to capital, minimum earnings sufficient to absorb losses, a minimum ratio of market value to book value for publicly traded shares and such other standards as the agencies deem appropriate.

Reigle-Neal Interstate Banking Bill

In 1994, Congress passed the Reigle-Neal Interstate Banking Bill (the "Interstate Bill"). The Interstate Bill permits certain interstate banking activities through a holding company structure, effective September 30, 1995. It permits interstate branching by merger effective June 1, 1997 unless states "opt-in" sooner, or "opt-out" before that date. States may elect to permit de novo branching by specific legislative election. In March, 1996, West Virginia adopted changes to its banking laws so as to permit interstate banking and branching to the fullest extent permitted by the Interstate Bill. The Interstate Bill permits consolidation of banking institutions across state lines and, under certain conditions, de novo entry.

USA PATRIOT Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (“USA PATRIOT Act”) is a comprehensive anti-terrorism legislation. The USA PATRIOT Act requires financial institutions to help prevent, detect and prosecute international money laundering and the financing of terrorism. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to our bank, or the BHCA, which applies to Summit. We, and our subsidiaries, including the bank, have adopted systems and procedures to comply with the USA PATRIOT Act and its regulations as adopted by the Secretary of the Treasury.

Community Reinvestment Act

Financial holding companies and their subsidiary banks are also subject to the provisions of the Community Reinvestment Act of 1977 (“CRA”). Under the CRA, the FRB (or other appropriate bank regulatory agency) is required, in connection with its examination of a bank, to assess such bank’s record in meeting the credit needs of the communities served by that bank, including low and moderate income neighborhoods. Further such assessment is also required of any financial holding company which has applied to (i) charter a national bank, (ii) obtain deposit insurance coverage for a newly chartered institution, (iii) establish a new branch office that will accept deposits, (iv) relocate an office, or (v) merge or consolidate with, or acquire the assets or assume the liabilities of a federally-regulated financial institution. In the case of a financial holding company applying for approval to acquire a bank or other financial holding company, the FRB will assess the record of each subsidiary of the applicant financial holding company, and such records may be the basis for denying the application or imposing conditions in connection with approval of the application. On December 8, 1993, the Federal regulators jointly announced proposed regulations to simplify enforcement of the CRA by substituting the present twelve categories with three assessment categories for use in calculating CRA ratings (the “December 1993 Proposal”). In response to comments received by the regulators regarding the December 1993 Proposal, the federal bank regulators issued revised CRA proposed regulations on September 26, 1994 (the “Revised CRA Proposal”). The Revised CRA Proposal, compared to the December 1993 Proposal, essentially broadens the scope of CRA performance examinations and more explicitly considers community development activities. Moreover, in 1994, the Department of Justice became more actively involved in enforcing fair lending laws.

In the most recent CRA examination by the bank regulatory authorities, Summit Community Bank was given a “satisfactory” CRA rating.

Graham-Leach-Bliley Act of 1999

The enactment of the Graham-Leach-Bliley Act of 1999 (the “GLB Act”) represents a pivotal point in the history of the financial services industry. The GLB Act swept away large parts of a regulatory framework that had its origins in the Depression Era of the 1930s. New opportunities were available for banks, other depository institutions, insurance companies and securities firms to enter into combinations that permit a single financial services organization to offer customers a more complete array of financial products and services. The GLB Act provides a new regulatory framework through the financial holding company, which has as its “umbrella regulator” the FRB. Functional regulation of the financial holding company’s separately regulated subsidiaries is conducted by their primary functional regulators. The GLB Act makes a CRA rating of satisfactory or above necessary for insured depository institutions and their financial holding companies to engage in new financial activities. The GLB Act specifically gives the FRB the authority, by regulation or order, to expand the list of “financial” or “incidental” activities, but requires consultation with the U.S. Treasury Department, and gives the FRB authority to allow a financial holding company to engage in any activity that is “complementary” to a financial activity and does not “pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.”

Under the GLB Act, all financial institutions are required to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer’s request, and establish procedures and practices to protect customer data from unauthorized access. We have established policies and procedures to assure our compliance with all privacy provisions of the GLB Act.

Deposit Acquisition Limitation

Under West Virginia banking law, an acquisition or merger is not permitted if the resulting depository institution or its holding company, including its affiliated depository institutions, would assume additional deposits to cause it to

control deposits in the State of West Virginia in excess of twenty five percent (25%) of such total amount of all deposits held by insured depository institutions in West Virginia. This limitation may be waived by the Commissioner of Banking by showing good cause.

Consumer Laws and Regulations

In addition to the banking laws and regulations discussed above, bank subsidiaries are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. Among the more prominent of such laws and regulations are the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, and the Fair Housing Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. Bank subsidiaries must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

Sarbanes-Oxley Act of 2002

On July 30, 2002, the Sarbanes-Oxley Act of 2002 ("SOA") was enacted, which addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. Effective August 29, 2002, as directed by Section 302(a) of SOA, our Chief Executive Officer and Chief Financial Officer are each required to certify that Summit's Quarterly and Annual Reports do not contain any untrue statement of a material fact. The rules have several requirements, including requiring these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal controls; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal controls; and they have included information in Summit's Quarterly and Annual Reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation.

Furthermore, in November 2003, in response to the directives of the SOA, NASDAQ adopted substantially expanded corporate governance criteria for the issuers of securities quoted on the NASDAQ Capital Market (the market on which our common stock is listed for trading). The new NASDAQ rules govern, among other things, the enhancement and regulation of corporate disclosure and internal governance of listed companies and the authority, role and responsibilities of their boards of directors and, in particular, of "independent" members of such boards of directors, in the areas of nominations, corporate governance, compensation and the monitoring of the audit and internal financial control processes.

Competition

We engage in highly competitive activities. Each activity and market served involves competition with other banks and savings institutions, as well as with non-banking and non-financial enterprises that offer financial products and services that compete directly with our products and services. We actively compete with other banks, mortgage companies and other financial service companies in our efforts to obtain deposits and make loans, in the scope and types of services offered, in interest rates paid on time deposits and charged on loans, and in other aspects of banking.

In addition to competing with other banks and mortgage companies, we compete with other financial institutions engaged in the business of making loans or accepting deposits, such as savings and loan associations, credit unions, industrial loan associations, insurance companies, small loan companies, finance companies, real estate investment trusts, certain governmental agencies, credit card organizations and other enterprises. In recent years, competition for money market accounts from securities brokers has also intensified. Additional competition for deposits comes from government and private issues of debt obligations and other investment alternatives for depositors such as money market funds. We take an aggressive competitive posture, and intend to continue vigorously competing for market share within our service areas by offering competitive rates and terms on both loans and deposits.

Transactions with Affiliates

There are various statutory and regulatory limitations, including those set forth in sections 23A and 23B of the Federal Reserve Act and the related Federal Reserve Regulation W, governing the extent to which the bank will be able to purchase assets from or securities of or otherwise finance or transfer funds to us or our nonbanking affiliates. Among other restrictions, such as transactions between the bank and any one affiliate (including Summit) generally will be limited to 10% of the bank's capital and surplus, and transactions between the bank and all affiliates will be limited to 20% of the bank's capital and surplus. Furthermore, loans and extensions of credit are required to be secured in specified amounts and are required to be on terms and conditions consistent with safe and sound banking practices.

In addition, any transaction by a bank with an affiliate and any sale of assets or provisions of services to an affiliate generally must be on terms that are substantially the same, or at least as favorable, to the bank as those prevailing at the time for comparable transactions with nonaffiliated companies.

Employees

At February 15, 2012, we employed 230 full-time equivalent employees.

Available Information

Our internet website address is www.summitfgi.com, and our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K, and amendments to such filed reports with the Securities and Exchange Commission (“SEC”) are accessible through this website free of charge as soon as reasonably practicable after we electronically file such reports with the SEC. The information on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filing with the Securities and Exchange Commission.

These reports are also available at the SEC’s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. You may read and copy any materials that we file with the SEC at the Public Reference Room. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Statistical Information

The information noted below is provided pursuant to Guide 3 – Statistical Disclosure by Bank Holding Companies.

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Item 1A. Risk Factors

We, like other financial holding companies, are subject to a number of risks that may adversely affect our financial condition or results of operation, many of which are outside of our direct control, though efforts are made to manage those risks while optimizing returns. Among the risks assumed are: (1) credit risk, which is the risk of loss due to loan clients or other counterparties not being able to meet their financial obligations under agreed upon terms, (2) market risk, which is the risk of loss due to changes in the market value of assets and liabilities due to changes in market interest rates, equity prices, and credit spreads, (3) liquidity risk, which is 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, investor and customer perception of financial strength, and events unrelated to the Company such as war, terrorism, or financial institution market specific issues, and (4) operational risk, which is the risk of loss due to human error, inadequate or failed internal systems and controls, violations of, or noncompliance with, laws, rules, regulations, prescribed practices, or ethical standards, and external influences such as market conditions, fraudulent activities, disasters, and security risks.

In addition to the other information included or incorporated by reference into this report, readers should carefully consider that the following important factors, among others, could materially impact our business, future results of operations, and future cash flows.

Risks Relating to the Economic Environment

Our business has been and may continue to be adversely affected by current conditions in the financial markets and economic conditions generally.

Negative developments in the financial services industry have resulted in uncertainty in the financial markets in general and a related general economic downturn. In addition, as a consequence of the recession in the United States, beginning in the latter half of 2007, business activity across a wide range of industries faces serious difficulties due to the lack of consumer spending and the extreme lack of liquidity in the global credit markets. Unemployment has also increased significantly.

As a result of these financial economic crises, many lending institutions, including us, have experienced declines in the performance of their loans, including construction and land development loans, residential real estate loans, commercial real estate loans and consumer loans. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected. In addition, the ability of banks and bank holding companies to raise capital or borrow in the debt markets has become more difficult compared to recent years. As a result, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations, including the expected issuance of many formal or informal enforcement actions or orders. The impact of new legislation in response to those developments may negatively impact our operations by restricting our business operations, including our ability to originate loans, and adversely impact our financial performance or our stock price.

Further negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these

difficult market conditions on us and others in the financial services industry.

In addition, the market for some of the investment securities held in our portfolio remains volatile, which may detrimentally affect the value of these securities, such as through reduced valuations due to the perception of heightened credit and liquidity risks. There can be no assurance that the declines in market value associated with these disruptions will not result in other than temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

Overall, during the past year, the general business environment has had an adverse effect on our business, and there can be no assurance that the environment will improve in the near term. Until conditions improve, we expect our business, financial condition and results of operations to be adversely affected.

Further downturn in our real estate markets could hurt our business.

Substantially all of our real estate loans are located in West Virginia and Virginia. While we do not have any sub-prime loans, our construction and development and residential real estate loan portfolios, along with our commercial real estate loan portfolio and certain of our other loans, have been affected by the recent downturn in the residential and commercial real estate market. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature. We anticipate that further declines in the real estate markets in our primary market areas would affect our business. If real estate values continue to decline, the collateral for our loans will provide less security. As a result, our ability to

recover on defaulted loans by selling the underlying real estate will be diminished, and we would be more likely to suffer losses on defaulted loans. The events and conditions described in this risk factor could therefore have a material adverse effect on our business, results of operations and financial condition.

The soundness of other financial institutions could adversely affect us.

Since mid-2007, the financial services industry as a whole, as well as the securities markets generally, have been materially and adversely affected by very significant declines in the values of nearly all asset classes and by a very serious lack of liquidity. Financial institutions in particular have been subject to increased volatility and an overall loss in investor confidence.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to different industries and counterparties, and we execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. There is no assurance that any such losses or defaults would not materially and adversely affect our business, financial condition or results of operations.

The unprecedented levels of market volatility may adversely impact our ability to access capital or our business, financial condition and results of operations.

The volatility and disruption of the capital and credit markets have reached unprecedented levels, adversely impacting the stock prices and credit availability for certain issuers, often without regard to their financial capabilities. If the current levels of market disruption and volatility continue or further deteriorate, our ability to access capital or our business, financial condition and results of operations could be adversely impacted.

The Dodd-Frank Act may adversely affect our business, financial condition and results of operations.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), into law. The Dodd-Frank Act significantly changes regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes, among other things, provisions creating a Financial Services Oversight Council to identify emerging systemic risks and improve interagency cooperation; centralizing the responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, which will be responsible for implementing, examining and enforcing compliance with federal consumer financial laws; permanently raising the current standard maximum deposit insurance amount to \$250,000; establishing strengthened capital standards for banks and disallowing trust preferred securities as qualifying for Tier 1 capital (subject to certain grandfather provisions for existing trust preferred securities); establishing new minimum mortgage underwriting standards; granting the Federal Reserve Board the power to regulate debit card interchange fees; and implementing numerous corporate governance changes. Many aspects of the Dodd-Frank Act are subject to rulemaking that will take effect over several years, thus making it difficult to assess all the effects the Dodd-Frank Act will have on the financial industry, including Summit, at this time. The changes resulting from the Dodd-Frank Act may impact the profitability of our operations, require us to change certain business practices, impose on us more stringent capital, liquidity and leverage requirements, or otherwise adversely affect our operations. We expect that operating and compliance costs will increase and could adversely affect Summit's financial condition and results of operations.

In addition, these changes may also require Summit to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements which may negatively impact Summit's financial condition and results of operation. Summit is currently reviewing the provisions of the Dodd-Frank Act and assessing their probable impact on Summit and its operations.

Risks Relating to Our Business

We are subject to certain supervisory actions by bank supervisory authorities that could have a material negative effect on our business, financial condition and the value of our common stock.

On September 24, 2009, as amended effective February 1, 2011, Summit Community entered into an informal Memorandum of Understanding ("Bank MOU") with the FDIC and the West Virginia Division of Banking. A memorandum of understanding is characterized by 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 Bank MOU, we have agreed to address the following matters relative to the Bank:

- § increased monitoring of the Bank's current financial position;
- § approval of an internally-prepared written risk assessment of all business activities and product lines of the Bank and the establishment of goals and limitations for each such business activity or product identified as containing elevated degrees of risk;
- § achieving and maintaining a minimum Tier 1 leverage capital ratio of at least 8% and a total-risk-based capital ratio of at least 11%;

- § declaring an intent to pay a cash dividend only if we give 30 days prior notice to our regulatory authorities and they do not object;
- § reviewing the adequacy of the Bank's loan policies and approving necessary changes to strengthen credit administration and risk identification;
 - § reviewing the investment policy and approving changes as appropriate;
 - § reviewing the organizational structure of the Bank's lending department;
- § providing the Bank's regulatory authorities with updated reports of criticized assets and/or formal work-out plans for all nonperforming borrowers with outstanding balances exceeding \$1.0 million;
- § establishing procedures to report all loans with balances exceeding \$500,000 that have credit weaknesses or that fall outside of the Bank's policy;
 - § maintaining an adequate allowance for loan and lease losses through charges to current operating income;
- § employing a qualified independent third party to assess the procedures used to estimate the Bank's allowance for loan and lease losses in accordance with FAS 5 and FAS 114;
 - § preparing an updated comprehensive budget and earnings forecast for the bank;
 - § developing a comprehensive three-year strategic plan for the bank;
- § reviewing overall liquidity objectives and developing and submitting to regulatory authorities plans and procedures aimed to improve liquidity and reduce reliance on volatile liabilities;
- § performing a risk segmentation analysis of concentrations of credit and developing a plan to reduce any segment of the portfolio which regulatory authorities deem to be an undue concentration of credit; and
- § providing quarterly progress reports to the Bank's regulatory authorities detailing steps taken to comply with the Bank MOU.

In addition to the Bank MOU, on November 6, 2009, Summit entered into an informal Memorandum of Understanding ("Holding Company MOU") with its principal regulators, the West Virginia Division of Banking and the FRB of Richmond. Under the terms of the Holding Company MOU, we agreed to:

- § promote compliance with the provisions of the Bank MOU;
- § suspend all cash dividends on our common stock until further notice;
- § not incur any additional debt, other than trade payables, without the prior written consent of the principal banking regulators;
- § adopt and implement a capital plan that is acceptable to the principal banking regulators and that is designed to maintain an adequate level and composition of capital protection commensurate for the risk profile of the organization; and

§ provide quarterly progress reports to Summit's regulatory authorities detailing the steps taken to comply with the Holding Company MOU.

Dividends on all preferred stock, including the Series 2009 and Series 2011 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 Federal Reserve should we continue to experience deterioration in our financial condition.

Although dividends from the Bank are our principal source of funds to pay dividends and interest payments on our common stock, preferred stock, trust preferred debt and subordinated debt, we currently have sufficient cash on hand to continue to service our trust preferred and subordinated debt obligations as well as the expected dividend payments on our preferred stock through at least 2013. Nevertheless, we can make no assurances that we will continue to have sufficient funds available for distributions to the holders of our preferred stock or that such dividends will continue to be permitted by our regulatory authorities.

The Bank MOU and Holding Company MOU (the "MOUs") will remain in effect until modified, terminated, lifted, suspended or set aside by the regulatory authorities.

If we were unable to meet the requirements of the MOUs in a timely manner, we could become subject to additional supervisory action, including a cease and desist order. If our regulators were to take such additional supervisory action, we could, among other things, become subject to significant restrictions on our ability to develop any new business, as well as restrictions on our existing business, and we could be required to raise additional capital, dispose of certain assets and liabilities within a prescribed period of time, or both. The terms of any such supervisory action could have a material negative effect on our business, our financial condition and the value of our common stock. Additionally, there can be no assurance that we will not be subject to further supervisory action or regulatory proceedings.

We may become subject to additional regulatory restrictions in the event that our regulatory capital levels decline.

Although we and the Bank both qualified as "well capitalized" under the regulatory framework for prompt corrective action as of December 31, 2011, there is no guarantee that we will not have a decline in our capital category in the future. In the event of such a capital category decline, we would be subject to increased regulatory restrictions which could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects.

If the bank is classified as undercapitalized, the bank is required to submit a capital restoration plan to the FDIC. Pursuant to FDICIA, an undercapitalized bank is prohibited from increasing its assets, engaging in a new line of business, acquiring any interest in any company or insured depository institution, or opening or acquiring a new branch office, except under certain circumstances, including the acceptance by the FDIC of a capital restoration plan for the bank. Furthermore, if a state non-member bank is classified as undercapitalized, the FDIC may take certain actions to correct the capital position of the bank; if a bank is classified as significantly undercapitalized or critically undercapitalized, the FDIC would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring sales of new securities to bolster capital; improvements in management; limits on interest rates paid; prohibitions on transactions with affiliates; termination of certain risky activities and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, FDICIA requires the bank to be placed into conservatorship or receivership within 90 days, unless the Federal Reserve determines that other action would better achieve the purposes of FDICIA regarding prompt corrective action with respect to undercapitalized banks.

Under FDICIA, banks may be restricted in their ability to accept broker deposits, depending on their capital classification. "Well-capitalized" banks are permitted to accept broker deposits, but all banks that are not well-capitalized could be restricted from accepting such deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized, such as the Bank, to accept broker deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank. These restrictions could materially and adversely affect our ability to access lower costs funds and thereby decrease our future earnings capacity.

Our financial flexibility could be severely constrained if we are unable to renew our wholesale funding or if adequate financing is not available in the future at acceptable rates of interest. We may not have sufficient liquidity to continue to fund new loan originations, and we may need to liquidate loans or other assets unexpectedly in order to repay obligations as they mature. Our inability to obtain regulatory consent to accept or renew brokered deposits could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects and our ability to continue as a going concern.

Finally, the capital classification of a bank affects the frequency of examinations of the bank, the deposit insurance premiums paid by such bank, and the ability of the bank to engage in certain activities, all of which could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects. Under FDICIA, the FDIC is required to conduct a full-scope, on-site examination of every bank at least once every twelve months. An exception to this rule is made, however, that provides that banks (i) with assets of less than \$100.0 million, (ii) that are categorized as “well-capitalized,” (iii) that were found to be well managed and whose composite rating was outstanding and (iv) that have not been subject to a change in control during the last twelve months, need only be examined by the FDIC once every 18 months.

Our decisions regarding credit risk could be inaccurate, and our allowance for loan losses may be inadequate, which could materially and adversely affect our business, financial condition, results of operations, cash flows and/or future prospects.

Our loan portfolio subjects us to credit risk. Inherent risks in lending also include fluctuations in collateral values and economic downturns. Making loans is an essential element of our business, and there is a risk that our loans will not be repaid.

We attempt to maintain an appropriate allowance for loan losses to provide for estimated probable credit losses inherent in our loan portfolio. As of December 31, 2011, our allowance for loan losses totaled \$17.7 million, which represents approximately 1.80% of our total loans. There is no precise method of predicting loan losses, and therefore, we always face the risk that charge-offs in future periods will exceed our allowance for loan losses and that we would need to make additional provisions to our allowance for loan losses.

Our methodology for the determination of the adequacy of the allowance for loan losses for impaired loans is based on classifications of loans into various categories and the application of generally accepted accounting principles in the United States. For non-classified loans, the estimated allowance is based on historical loss experiences as adjusted for changes in trends and conditions on at least an annual basis. In addition, on a quarterly basis, the estimated allowance for non-classified loans is adjusted for the probable effect that current environmental factors could have on the historical loss factors currently in use. While our allowance for loan losses is established in different portfolio components, we maintain an allowance that we believe is sufficient to absorb all estimated probable credit losses inherent in our portfolio.

In addition, the FDIC as well as the West Virginia Division of Banking review our allowance for loan and lease losses and may require us to establish additional reserves. Additions to the allowance for loan and lease losses will result in a decrease in our net earnings and capital and could hinder our ability to grow our assets.

We are subject to changes in public policy due to Health Care Reform that can adversely affect the markets for our insurance subsidiary's products and services and our profitability.

In March 2010, President Obama signed into law Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, "Health Care Reform") which makes broad-based changes to the U.S. health care system which could significantly affect the U.S. economy and will significantly impact the business operations and financial results of our insurance subsidiary, which markets and sells employee benefit products, including health insurance. It is reasonably possible that Health Care Reform, in the aggregate, could have a material adverse effect on our business operations and financial results.

We do business with other financial institutions that could experience financial difficulty.

We do business through the purchase and sale of Federal funds, check clearing and through the purchase and sale of loan participations with other financial institutions. Because these financial institutions have many risks, as do we, we could be adversely effected should one of these financial institutions experience significant financial difficulties or fail to comply with our agreements with them.

We may elect or be compelled to seek additional capital in the future, but capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. In addition, we may elect to raise additional capital to support our business or to finance acquisitions, if any, or we may otherwise elect to raise additional capital. In that regard, a number of financial institutions have recently raised considerable amounts of capital as a result of deterioration in their results of operations and financial condition arising from the turmoil in the mortgage loan market, deteriorating economic conditions, declines in real estate values and other factors, which may diminish our ability to raise additional capital.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside our control, and on our financial performance. Accordingly, we cannot be assured of our ability to raise additional capital if needed or on terms

acceptable to us. If we cannot raise additional capital when needed, it may have a material adverse effect on our financial condition, results of operations and prospects.

We rely on funding sources to meet our liquidity needs, such as brokered deposits and FHLB borrowings, which are generally more sensitive to changes in interest rates and can be adversely affected by general economic conditions.

We have frequently utilized as a source of funds certificates of deposit obtained through deposit brokers that solicit funds from their customers for deposit with us, or brokered deposits. Brokered deposits, when compared to retail deposits attracted through a branch network, are generally more sensitive to changes in interest rates and volatility in the capital markets and could reduce our net interest spread and net interest margin. In addition, brokered deposit funding sources may be more sensitive to significant changes in our financial condition. As of December 31, 2011, brokered deposits totaled \$169.2 million, or approximately 16.6% of our total deposits, compared to brokered deposits in the amount of \$230.3 million or approximately 22.2% of our total deposits at December 31, 2010. As of December 31, 2011, approximately \$27.8 million in brokered deposits, or approximately 16.4% of our total brokered deposits, are short-term and mature within one year. Our ability to continue to acquire brokered deposits is subject to our ability to price these deposits at competitive levels, which may increase our funding costs, and the confidence of the market. In addition, if our capital ratios fall below the levels necessary to be considered “well-capitalized” under current regulatory guidelines, we could be restricted from using brokered deposits as a funding source.

We also have borrowings with the Federal Home Loan Bank, or the FHLB. As of December 31, 2011, our FHLB borrowings maturing within one year totaled \$52.6 million. If we were unable to borrow from the FHLB in the future, we may be required to seek higher cost funding sources, which could materially and adversely affect our net interest income.

Summit operates in a very competitive industry and market.

We face aggressive competition not only from banks, but also from other financial services companies, including finance companies and credit unions, and, to a limited degree, from other providers of financial services, such as money market mutual funds, brokerage firms, and consumer finance companies. A number of competitors in our market areas are larger than we are and have substantially greater access to capital and other resources, as well as larger lending limits and branch systems, and offer a wider array of banking services. Many of our non-bank competitors are not subject to the same extensive regulations that govern us. As a result, these non-bank competitors have advantages over us in providing certain services. Our profitability depends upon our ability to attract loans and deposits. There is a risk that aggressive competition could result in our controlling a smaller share of our markets. A decline in market share could adversely affect our results of operations and financial condition.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on those properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Changes in interest rates could negatively impact our future earnings.

Changes in interest rates could reduce income and cash flow. Our income and cash flow depend primarily on the difference between the interest earned on loans and investment securities, and the interest paid on deposits and other borrowings. Interest rates are beyond our control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, will influence loan originations, purchases of investments, volumes of deposits, and rates received on loans and investment securities and paid on deposits. Our results of operations may be adversely affected by increases or decreases in interest rates or by the shape of the yield curve.

Concern of customers over deposit insurance may cause a decrease in deposits.

With recent increased concerns about bank failures, customers increasingly are concerned about the extent to which their deposits are insured by the FDIC. Customers may withdraw deposits in an effort to ensure that the amount they have on deposit with their bank is fully insured. Decreases in deposits may adversely affect our funding costs and net income.

Our business is subject to significant government regulation.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the West Virginia Division of Banking, the Federal Reserve Board and the FDIC. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law.

As a result, significant new legislation and regulatory reform passed in 2010 and 2011 and future legislation and government policy could adversely affect the banking industry as a whole, including our results of operations. New legislation or regulation may limit the manner in which we may conduct our business, including our ability to offer new products, assess fees, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads.

Our deposit insurance premium could be substantially higher in the future, which could have a material adverse effect on our future earnings.

The FDIC insures deposits at FDIC insured financial institutions, including Summit Community. The FDIC charges the insured financial institutions premiums to maintain the Deposit Insurance Fund at a certain level. Current economic conditions have increased bank failures and expectations for further failures, in which case the FDIC ensures payments of deposits up to insured limits from the Deposit Insurance Fund.

On October 16, 2008, the FDIC published a restoration plan designed to replenish the Deposit Insurance Fund over a period of five years and to increase the deposit insurance reserve ratio, which had decreased to 1.01% of insured deposits as of June 30, 2008, to the statutory minimum of 1.15% of insured deposits by December 31, 2013. In order to implement the restoration plan, the FDIC changed both its risk-based assessment system and its base assessment rates. For the first quarter of 2009 only, the FDIC increased all FDIC deposit assessment rates by 7 basis points. These new rates range from 12-14 basis points for Risk Category I institutions to 50 basis points for Risk Category IV institutions. Under the FDIC's restoration plan, the FDIC established new initial base assessment rates that are subject to adjustment as described below. Beginning April 1, 2009, the base assessment rates range from 10-14 basis points for Risk Category I institutions to 45 basis points for Risk Category IV institutions. Changes to the risk-based assessment system include increasing premiums for institutions that rely on excessive amounts of brokered deposits, including CDARS, increasing premiums for excessive use of secured liabilities, including Federal Home Loan Bank advances, lowering premiums for smaller institutions with very high capital levels, and adding financial ratios and debt issuer ratings to the premium calculations for banks with over \$10 billion in assets, while providing a reduction for their unsecured debt.

On May 22, 2009, the FDIC approved a final rule to institute a one-time special assessment of five cents per \$100 of the difference between each insured institution's total assets and its Tier 1 capital as of June 30, 2009. The assessment was collected on September 30, 2009. The FDIC also stated that additional special assessments may be announced in the future.

In April 2011, the FDIC implemented rulemaking under the Dodd-Frank Act to reform the deposit insurance assessment system. The final rule redefined the assessment base used for calculating deposit insurance assessments. Specifically, the rule bases assessments on an institution's total assets less tangible capital, as opposed to total deposits. Since the new base is larger than the prior base, the FDIC also lowered the assessment rates so that the rules would not significantly alter the total amount of revenue collected from the industry. The new assessment scale ranges from 2.5 basis points for the least risky institutions to 45 basis points for the riskiest. Either an increase in the Risk Category of Summit Community or adjustments to the base assessment rates could have a material adverse effect on our earnings.

We rely heavily on our management team and the unexpected loss of key officers could adversely affect our business, financial condition, results of operations, cash flows and/or future prospects.

Our success has been and will continue to be greatly influenced by our ability to retain the services of existing senior management and, as we expand, to attract and retain qualified additional senior and middle management. Our senior executive officers have been instrumental in the development and management of our business. The loss of the services of any of our senior executive officers could have an adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects. We have not established a detailed management succession plan. Accordingly, should we lose the services of any of our senior executive officers, our Board of Directors may have to search outside of Summit Financial Group for a qualified permanent replacement. This search may be prolonged and we cannot assure you that we will be able to locate and hire a qualified replacement. If any of our senior executive officers leaves his or her respective position, our business, financial condition, results of operations, cash flows and/or future prospects may suffer.

An interruption in or breach in security of our information systems may result in a loss of customer business and have an adverse affect on our results of operations, financial condition and cash flows.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposits, servicing or loan origination systems. Although we have policies and procedures designed to

prevent or minimize the effect of a failure, interruption or breach in security of our communications or information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur, or if they do occur, that they will be adequately addressed. The occurrence of any such failures, interruptions or security breaches could result in a loss of customer business and have a negative effect on our results of operations, financial condition and cash flows.

Changes in accounting standards could impact reported earnings.

The accounting standard setting bodies, including the Financial Accounting Standards Board and other regulatory bodies periodically change the financial accounting and reporting standards affecting the preparation of financial statements. These changes are not within our control and could materially impact our financial statements.

Our business is dependent on technology and our inability to invest in technological improvements may adversely affect our results of operations, financial condition and cash flows.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success depends in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as create additional efficiencies in its operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers, which may negatively affect our results of operations, financial condition and cash flows.

Risks Relating to an Investment in Our Securities

Our ability to pay dividends is limited and we have stopped paying cash dividends.

We are a separate and distinct legal entity from our subsidiaries. We receive substantially all of our revenue from dividends from our subsidiary bank, Summit Community. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that Summit Community may pay to Summit. Also, Summit's right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event Summit Community is unable to pay dividends to us, we may not be able to service debt, pay obligations or pay dividends on either our common stock or our Series 2009 or Series 2011 preferred stock. The inability to receive dividends from Summit Community could have a material adverse effect on our business, financial condition and results of operations.

Under the terms of the Bank MOU, Summit Community may pay dividends to us if they give 30 days prior notice to the FDIC and the West Virginia Division of Banking and they do not object. In addition, under the terms of the Holding Company MOU, we have suspended all cash dividends on our common stock until further notice. Dividends on all preferred stock, including the Series 2009 and Series 2011 preferred stock, as well as interest payments on subordinated notes underlying our trust preferred securities, continue to be permissible. However, no assurances can be given that such payments will be permitted in the future if we continue to experience deterioration in our financial condition.

The market price for shares of our common stock may fluctuate.

The market price of our common stock could be subject to significant fluctuations due to a change in sentiment in the market regarding our operations or business prospects. Such risks may include:

- § Operating results that vary from the expectations of management, securities analysts and investors;
 - § Developments in our business or in the financial sector generally;
 - § Regulatory changes affecting our industry generally or our businesses and operations;
- § The operating and securities price performance of companies that investors consider to be comparable to us;
- § Announcements of strategic developments, acquisitions and other material events by us or our competitors;
- § Changes in the credit, mortgage and real estate markets, including the markets for mortgage-related securities;
- § Changes in global financial markets and global economies and general market conditions, such as interest or foreign exchange rates, stocks, commodity, credit or asset valuations or volatility;
 - § Changes in securities analysts' estimates of financial performance

- § Volatility of stock market prices and volumes
 - § Rumors or erroneous information
- § Changes in market valuations of similar companies
 - § Changes in interest rates
 - § New developments in the banking industry
- § Variations in our quarterly or annual operating results
 - § New litigation or changes in existing litigation
 - § Regulatory actions

Stock markets in general and our common stock in particular have, over the past year, and continue to be, experiencing significant price and volume volatility. As a result, the market price of our common stock may continue to be subject to similar market fluctuations that may be unrelated to our operating performance or prospects. Increased volatility could result in a decline in the market price of our common stock.

Our executive officers and directors own shares of our common stock, allowing management to have an impact on our corporate affairs.

As of February 28, 2012 our executive officers and directors beneficially own 35.03% of the outstanding shares of our common stock. Accordingly, these executive officers and directors will be able to impact the outcome of all matters required to be submitted to our stockholders for approval, including decisions relating to the election of directors, the determination of our day-to-day corporate and management policies and other significant corporate transactions.

Your share ownership may be diluted by the issuance of additional shares of our common stock in the future and by the conversion of our Series 2009 or Series 2011 Preferred Stock.

Your share ownership may be diluted by the issuance of additional shares of our common stock in the future. In 1998, we adopted a stock option plan (the "1998 Plan") that provided for the granting of stock options to our directors, executive officers and other employees. Although the 1998 Plan expired in May, 2008, as of December 31, 2011, 309,180 shares of our common stock are still issuable under options granted in connection with our 1998 Plan. At our 2009 Annual Meeting of shareholders, a new officer stock option plan was approved providing for 350,000 shares of common stock to be available for issuance under the plan. As of December 31, 2011, 8,000 shares of our common stock are issuable under options granted in connection with our 2009 Plan. It is probable that the stock options will be exercised during their respective terms if the fair market value of our common stock exceeds the exercise price of the particular option. If the stock options are exercised, your share ownership will be diluted.

In addition, our amended and restated articles of incorporation authorize the issuance of up to 20,000,000 shares of common stock, but do not provide for preemptive rights to the holders of our common stock. Any authorized but unissued shares are available for issuance by our Board of Directors. As a result, if we issue additional shares of common stock to raise additional capital or for other corporate purposes, you may be unable to maintain your pro rata ownership in Summit Financial Group.

We have also issued 3,710 shares of our Series 2009 Preferred Stock and 12,000 shares of our Series 2011 Preferred Stock. The conversion of some or all of the Series 2009 or Series 2011 Preferred Stock will dilute the ownership interest of our existing common shareholders.

The market price of the Series 2009 and Series 2011 preferred stock will be directly affected by the market price of our common stock, which may be volatile.

To the extent that a secondary market for the Series 2009 or Series 2011 preferred stock develops, we believe that the market price of the Series 2009 or Series 2011 preferred stock will be significantly affected by the market price of our common stock. We cannot predict how the shares of our common stock will trade in the future. This may result in greater volatility in the market price of the Series 2009 or Series 2011 preferred stock than would be expected for nonconvertible preferred stock. The market price of our common stock will likely continue to fluctuate in response to a number of factors including the following, most of which are beyond our control:

- § actual or anticipated quarterly fluctuations in our operating and financial results;
- § our announcements of developments related to our business;
- § changes in financial estimates and recommendations by financial analysts;
- § dispositions, acquisitions and financings;

- § actions of our current shareholders, including sales of common stock by existing shareholders and our directors and executive officers;
- § fluctuations in the stock price and operating results of other companies deemed to be peers;
- § actions by government regulators; and
- § developments related to the financial services industry.

Our common share price may fluctuate significantly in the future, and these fluctuations may be unrelated to our performance. General market price declines or market volatility in the future could adversely affect the price of our common stock, and the current market price of such stock may not be indicative of future market prices.

Changes in United States tax laws may have a detrimental impact on the after-tax return on investment.

Changes in the tax law or a failure by Congress to extend or make permanent certain provisions of the Internal Revenue Code may adversely affect the after-tax return on investment by holders of our preferred stock or common stock. Specifically, the designation of dividends as qualified dividends currently results in a lower rate of taxation to certain taxpayers, including individuals. This provision is currently set to expire, and will no longer be available for tax years beginning after December 31, 2010. We can give no assurances that this provision will be extended or made permanent or that other detrimental changes in current tax law will not be enacted.

The conversion rate of the Series 2009 or Series 2011 preferred stock may not be adjusted for all dilutive events that may adversely affect the market price of the Series 2009 or Series 2011 preferred stock or the common stock issuable upon conversion of the Series 2009 or Series 2011 preferred stock.

The number of shares of our common stock that the holders of Series 2009 or Series 2011 preferred stock are entitled to receive upon conversion of a share of their preferred stock is subject to adjustment for certain events arising from increases in cash dividends on our common stock, dividends or distributions in common stock or other property, certain issuances of stock purchase rights, certain self tender offers, subdivisions, splits and combinations of the common stock and certain other actions by us that modify our capital structure. We will not adjust the conversion rate for other events, including offerings of common stock for cash by us or in connection with acquisitions. There can be no assurance that an event that adversely affects the value of the Series 2009 or Series 2011 preferred stock, but does not result in an adjustment to the conversion rate, will not occur. Further, if any of these other events adversely affects the market price of our common stock, it may also adversely affect the market price of the Series 2009 or Series 2011 preferred stock. In addition, we are not restricted from offering common stock in the future or engaging in other transactions that could dilute our common stock.

The conversion of the Series 2009 or Series 2011 preferred stock will dilute the appreciation of our common stock.

Although our common stock may appreciate in value, the future conversion of the Series 2009 or Series 2011 preferred stock will dilute such appreciation. There is no guarantee that an investor in our common stock will recognize an increase in value after the impact of the conversion of the Series 2009 or Series 2011 preferred stock despite overall positive performance.

There may be future sales of additional common stock or preferred stock or other dilution of our equity, which may adversely affect the market price of our common stock or the Series 2009 or Series 2011 preferred stock.

Our board of directors is authorized to cause us to issue additional classes or series of preferred shares without any action on the part of the shareholders. The board of directors also has the power, without shareholder approval, to set the terms of any such classes or series of preferred shares that may be issued, including voting rights, dividend rights and preferences over the common stock with respect to dividends or upon the liquidation, dissolution or winding-up of our business and other terms. If we issue preferred shares in the future that have a preference over the common stock with respect to the payment of dividends or upon liquidation, dissolution or winding-up, or if we issue preferred shares with voting rights that dilute the voting power of the common stock, the rights of holders of the common stock or the market price of the common stock could be adversely affected.

The market price of our common stock or preferred stock, including the Series 2009 and Series 2011 preferred stock, could decline as a result of sales of a large number of shares of common stock or preferred stock or similar securities in the market after this offering or the perception that such sales could occur. The conversion of some or all of the Series 2009 or Series 2011 preferred stock will dilute the ownership interest of our existing common shareholders. Any sales in the public market of our common stock issuable upon such conversion could adversely affect prevailing market prices of the outstanding shares of our common stock and the Series 2009 and Series 2011 preferred stock.

Holders of our junior subordinated debentures and our subordinated debt have rights that are senior to those of our stockholders.

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 of these unconsolidated statutory trusts totaled \$19,589,000 at December 31, 2011 and 2010.

Distributions on the capital securities issued by the trusts are payable quarterly at the variable interest rates specified in those certain securities. The capital securities are subject to mandatory redemption in whole or in part, upon repayment of the debentures.

Payments of the principal and interest on the trust preferred securities of the statutory trusts are conditionally guaranteed by us. The junior subordinated debentures are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We have the right to defer distributions on the junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on our common stock. In 2011, our total interest payments on these junior subordinated debentures approximated \$524,000. Based on current rates, our quarterly interest payment obligation on our junior subordinated debentures is approximately \$130,000.

The capital securities held by our three trust subsidiaries 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.

We have also issued \$16.8 million of subordinated debt. In 2008, \$10 million of this debt was issued to an unaffiliated financial institution, bears a variable interest rate of 1 month LIBOR plus 275 basis points, a term of 7.5 years, and is not prepayable by us within the first two and one half years. During 2009, \$5 million was issued to an affiliate of a director of Summit, and \$1.0 million and \$0.8 million was issued to two unrelated parties. These 2009 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. Like the junior subordinated debentures, the subordinated debt is senior to our common stock and we must make payments on the subordinated debt before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the subordinated debt must be satisfied before any distributions can be made on our common stock. 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. Our total interest payments on this subordinated debt in 2011 were approximately \$992,000. Based upon the current rate, our quarterly interest payment obligation on this debt is approximately \$245,000.

Holders of our Series 2009 and Series 2011 Preferred Stock have rights senior to those of our common stockholders.

During fourth quarter 2011, we issued 12,000 shares of our Series 2011 preferred stock in the amount of \$5.81 million. Also, in September 2009, we issued 3,710 shares of our Series 2009 preferred stock in the amount of \$3.71 million. Our Series 2011 and Series 2009 preferred stock has rights and preferences that could adversely affect holders of our common stock. For example, upon any voluntary or involuntary liquidation, dissolution, or winding up of our business, the holders of our Series 2011 and Series 2009 preferred stock are entitled to receive distributions out of our available assets before any distributions can be made to holders of our common stock.

Provisions of our amended and restated articles of incorporation could delay or prevent a takeover of us by a third party.

Our amended and restated articles of incorporation could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our stockholders, or could otherwise adversely affect the price of our common stock. For example, our amended and restated articles of incorporation contain advance notice requirements for nominations for election to our Board of Directors. We also have a staggered board of directors, which means that only one-third of our Board of Directors can be replaced by stockholders at any annual meeting.

Your shares are not an insured deposit.

Your investment in our common stock is not a bank deposit and is not insured or guaranteed by the FDIC or any other government agency. Your investment is subject to investment risk, and you must be capable of affording the loss of your entire investment.

Other

Additional factors could have a negative effect on our financial performance and the value of our common stock. Some of these factors are general economic and financial market conditions, continuing consolidation in the financial services industry, new litigation or changes in existing litigation, regulatory actions, and losses.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our principal executive office is located at 300 North Main Street, Moorefield, West Virginia in a building owned by Summit Community. Summit Community's headquarters and branch locations occupy offices which are either owned or operated under long-term lease arrangements. At December 31, 2011, Summit Community operated 15 banking offices. Summit Insurance Services, LLC operates out of the Moorefield, West Virginia and Leesburg, Virginia offices of Summit Community, and also leases a location in Leesburg, Virginia.

Office Location	Number of Offices		
	Owned	Leased	Total
Summit Community Bank			
Moorefield, West Virginia	1	-	1
Mathias, West Virginia	1	-	1
Franklin, West Virginia	1	-	1
Petersburg, West Virginia	1	-	1
Charleston, West Virginia	2	-	2
Rainelle, West Virginia	1	-	1
Rupert, West Virginia	1	-	1
Winchester, Virginia	1	1	2
Leesburg, Virginia	1	-	1
Harrisonburg, Virginia	1	1	2
Warrenton, Virginia	-	1	1
Martinsburg, West Virginia	1	-	1
Summit Insurance Services, LLC			
Leesburg, Virginia	-	1	1

We believe that the premises occupied by us and our subsidiaries generally are well-located and suitably equipped to serve as financial services facilities. See Notes 7 and 8 of our consolidated financial statements on pages 71.

Item 3. Legal Proceedings

Information required by this item is set forth under the caption "Litigation" in Note 14 of our consolidated financial statements on page 79.

Item 4. Mine Safety Disclosures

Not applicable.

PART II.

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

Common Stock Dividend and Market Price Information: Our stock trades on the NASDAQ Capital Market under the symbol "SMMF". The following table presents cash dividends paid per share and information regarding bid prices per share of Summit's common stock for the periods indicated. The bid prices presented are based on information reported by NASDAQ, and may reflect inter-dealer prices, without retail mark-up, mark-down or commission and not represent actual transactions.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2011				
Dividends paid	\$ -	\$ -	\$ -	\$ -
High Bid	4.49	4.12	3.99	3.35
Low Bid	3.53	3.05	2.10	2.13
2010				
Dividends paid	\$ -	\$ -	\$ -	\$ -
High Bid	4.24	5.00	4.75	5.00
Low Bid	3.67	2.38	2.30	3.51

Historically, we have paid semi-annual dividends on our common stock on the 15th day of June and December, and the record date has been the 1st day of each respective month. The payment of dividends is subject to the restrictions set forth in the West Virginia Business Corporation Act and the limitations imposed by the Federal Reserve Board. We are presently restricted from paying dividends on our common shares as discussed in Item 1A. – Risk Factors on page 12 and Item 7. -- Management's Discussion and Analysis of Financial Condition and Results of Operations on page 26, and in Note 16 of our consolidated financial statements on page 80. Payment of dividends by Summit is primarily dependent upon receipt of dividends from Summit Community. Under the terms of the Bank MOU, Summit Community may only pay dividends to us if they give 30 days prior notice to the FDIC and the West Virginia Division of Banking and they do not object.

As of February 22, 2012, there were approximately 1,250 shareholders of record of Summit's common stock.

Purchases of Summit Equity Securities: We have an Employee Stock Ownership Plan ("ESOP"), which enables eligible employees to acquire shares of our common stock. The cost of the ESOP is borne by us through annual contributions to an Employee Stock Ownership Trust in amounts determined by the Board of Directors.

The following table sets forth certain information regarding Summit's purchase of its common stock under Summit's ESOP for the quarter ended December 31, 2011.

Period	Total Number of Shares	Average Price Paid per Share	Total Number of Shares	Maximum Number of
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	Purchased (a)		Purchased as Part of Publicly Announced Plans or Programs	Shares that May Yet be Purchased Under the Plans or Programs
October 1, 2011 - October 31, 2011	-	\$ -	-	-
November 1, 2011 - November 30, 2011	-	-	-	-
December 1, 2011 - December 31, 2011	14,477	3.23	-	-

(a) Shares repurchased under the Employee Stock Ownership Plan.

Item 6. Selected Financial Data

The following consolidated selected financial data is derived from our audited financial statements as of and for the five years ended December 31, 2011. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes contained elsewhere in this report.

Dollars in thousands, except per share amounts	For the Year Ended (unless otherwise noted)				
	2011	2010	2009	2008	2007
Summary of Operations					
Interest income	\$ 71,047	\$ 79,672	\$ 89,536	\$ 93,484	\$ 91,384
Interest expense	31,203	39,520	45,994	49,409	52,317
Net interest income	39,844	40,152	43,542	44,075	39,067
Provision for loan losses	10,000	21,350	20,325	15,500	2,055
Net interest income after provision					
for loan losses	29,844	18,802	23,217	28,575	37,012
Noninterest income	5,550	7,739	6,281	3,245	7,717
Noninterest expense	30,285	31,471	32,379	29,811	25,458
Income (loss) before income taxes	5,109	(4,930)	(2,881)	2,009	19,271
Income tax expense (benefit)	1,035	(2,955)	(2,165)	(291)	5,734
Income (loss) from continuing operations	4,074	(1,975)	(716)	2,300	13,537
Income (loss) from discontinued operations	-	-	-	-	(7,081)
Net income (loss)	4,074	(1,975)	(716)	2,300	6,456
Dividends on preferred shares	371	297	74	-	-
Net income (loss) applicable to common shares	\$ 3,703	\$ (2,272)	\$ (790)	\$ 2,300	\$ 6,456

Balance Sheet Data (at year end)					
Assets	\$ 1,450,121	\$ 1,477,570	\$ 1,584,625	\$ 1,627,116	\$ 1,435,536
Securities available for sale	286,599	271,730	271,654	327,606	283,015
Loans	965,516	995,319	1,137,336	1,192,157	1,052,489
Deposits	1,016,500	1,036,939	1,017,338	965,850	828,687
Short-term borrowings	15,956	1,582	49,739	153,100	172,055
Long-term borrowings	270,254	304,109	381,492	382,748	315,738
Shareholders' equity	102,566	89,821	90,660	87,244	89,420

Credit Quality

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Net loan charge-offs	\$ 9,512	\$ 21,126	\$ 20,258	\$ 7,759	\$ 1,066
Nonperforming assets	116,641	92,235	107,504	56,082	12,391
Allowance for loan losses	17,712	17,224	17,000	16,933	9,192

Per Share Data

Earnings per share from continuing operations

Basic earnings	\$ 0.50	\$ (0.31)	\$ (0.11)	\$ 0.31	\$ 1.87
Diluted earnings	0.49	(0.31)	(0.11)	0.31	1.85

Earnings per share from discontinued operations

Basic earnings	-	-	-	-	(0.98)
Diluted earnings	-	-	-	-	(0.97)

Earnings per share

Basic earnings	0.50	(0.31)	(0.11)	0.31	0.89
Diluted earnings	0.49	(0.31)	(0.11)	0.31	0.88

Book value per common share (at year end) (A)

Book value per common share (at year end) (A)	10.68	11.01	11.19	11.77	12.07
Tangible book value per common share (at year end) (A)	9.78	9.90	10.04	10.46	10.70
Cash dividends	-	-	0.06	0.36	0.34

Performance Ratios

Return on average equity	4.55	%	-2.60	%	-0.90	%	2.59	%	7.34	%
Return on average assets	0.28	%	-0.15	%	-0.05	%	0.15	%	0.50	%
Equity to assets	7.1	%	6.1	%	5.7	%	5.4	%	6.2	%

(A) - Assumes conversion of convertible preferred stock

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

FORWARD LOOKING STATEMENTS

This annual report contains comments or information that constitute forward looking statements (within the meaning of the Private Securities Litigation Act of 1995) that are based on current expectations that involve a number of risks and uncertainties. Words such as “expects”, “anticipates”, “believes”, “estimates” and other similar expressions or future or conditional verbs such as “will”, “should”, “would” and “could” are intended to identify such forward-looking statements. 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. 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.

Although we believe the expectations reflected in such forward looking statements are reasonable, actual results may differ materially. Factors that might cause such a difference include changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; the impact of technological advances; the outcomes of contingencies; trends in customer behavior as well as their ability to repay loans; and changes in the national and local economy.

DESCRIPTION OF BUSINESS

We are a \$1.45 billion community-based financial services company providing a full range of banking and other financial services to individuals and businesses through our two operating segments: community banking and insurance. Our community bank, Summit Community Bank, has a total of 15 banking offices located in West Virginia and Virginia. In addition, we also operate an insurance agency, Summit Insurance Services, LLC with an office in Moorefield, West Virginia which offers both commercial and personal lines of insurance and two offices in Leesburg, Virginia, primarily specializing in group health, life and disability benefit plans. See Note 17 of the accompanying consolidated financial statements for our segment information. Summit Financial Group, Inc. employs approximately 230 full time equivalent employees.

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.

Key Items in 2011

- Net income for 2011 totaled \$3,703,000 compared to net loss of \$2,272,000 in 2010. Net income was achieved in 2011 despite charges related to the writedowns of OREO properties to fair value and other than temporary impairments of securities.
- Our allowance for loan losses totaled 1.80% of total loans at December 31, 2011, compared to 1.70% at December 31, 2010, with our provision for loan losses totaling \$10 million in 2011 compared to \$21.4 million during 2010.
-

In 2011, nonperforming assets increased by \$24.4 million. We continue to manage our problem assets through a combination of asset sales, loan workouts and charge-offs. However, disposition of foreclosed real estate remains difficult to achieve as the return of our real estate markets to normal activity levels has been slow.

- The impact of foregone net interest income from nonaccruing loans negatively impacted the margin keeping it well below historical margins.
- During 2011, we reduced wholesale funding to 31% of total assets, compared to 39% a year ago.
- We issued 12,000 shares of Series 2011 8% Noncumulative Convertible Preferred Stock, representing \$5.8 million of new capital.
- We remained well-capitalized by regulatory capital guidelines at December 31, 2011, with our leverage ratio at its highest level in five years and our total risk-based capital ratio at its highest level in eleven years.

OUTLOOK

Summit remains well-capitalized and is adequately reserved. The Company has adequate liquidity and is positioned to weather the current economic conditions and maintain marginal profitability until conditions improve. In the short-term, however, Management anticipates the Company will continue to be negatively impacted by loan losses above historical averages, continuing high levels of nonperforming assets, a weak economy, and modest reductions in total assets and revenues.

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.

Our most significant accounting policies are presented in the notes to the accompanying consolidated financial statements. These policies, along with the disclosures presented in the other 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 Other Real Estate Owned (“OREO”) valuations 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 7 to the accompanying consolidated financial statements 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 this financial review.

Goodwill: Goodwill is subject to a two-step impairment test by reporting unit at least annually to determine whether write-downs of the recorded balances are necessary. During the third quarter, we completed the required annual impairment test for 2011 for each of our reporting units, community banking and insurance services. The first step (Step 1) of impairment testing requires a comparison of each reporting unit’s fair value to its carrying value to identify potential impairment. If the fair value equals or exceeds the related unit’s carrying value, no write-down of recorded goodwill is necessary. If the fair value is less than the carrying value, an expense may be required on our books to write down the goodwill to the proper carrying value. The second step (Step 2) of impairment testing is necessary only if the reporting unit does not pass Step 1. Step 2 compares the implied fair value of the reporting unit goodwill

with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination.

The fair value, carrying amount and allocated goodwill with regard to each of our reporting units as of September 30, 2011 (date of our most recent goodwill impairment test) were as follows:

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

Neither of our reporting units failed Step 1 of the goodwill impairment tests conducted as of September 30, 2011. For purposes of these goodwill impairment tests, the following methodologies were utilized and key assumptions were made in determining the fair value of each reporting unit:

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

Insurance Services – We performed an internal valuation, which was verified by a third party firm, utilizing the income approach to determine the fair value of our Insurance Services reporting unit. This methodology consisted of discounting the expected future cash flows of this unit based upon a forecast of its operations considering long-term key business drivers such as anticipated commission revenue growth. The long term growth rate used in determining the terminal value was estimated at 2.5%, and a discount rate of 11% was applied to the Insurance Services unit’s estimated future cash flows.

We cannot assure you that future goodwill impairment tests will not result in a charge to earnings. See Note 9 of the accompanying consolidated financial statements for further discussion of our intangible assets, which include goodwill.

Fair Value Measurements: ASC Topic 820 Fair Value Measurements 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 ASC Topic 820 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.

OREO Valuations: At December 31, 2011, we had OREO totaling \$63,938,000, which is 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 generally utilizing current “as is” appraisals performed by an independent, licensed appraiser applying an income or market value approach using observable market data. 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. 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.

Deferred Income Tax Assets: At December 31, 2011, we had net deferred tax assets of \$11.5 million. Based on our ability to offset the net deferred tax asset against expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at December 31, 2011. 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.

BUSINESS SEGMENT RESULTS

We are organized and managed along two major business segments, as described in Note 17 of the accompanying consolidated financial statements. The results of each business segment are intended to reflect each segment as if it were a stand alone business. Net income by segment follows:

Dollars in thousands	2011	2010	2009
Community banking	\$ 4,715	\$ (838)	\$ 563
Insurance	232	249	248
Parent and other	(1,244)	(1,683)	(1,601)
Consolidated net income	\$ 3,703	\$ (2,272)	\$ (790)

RESULTS OF OPERATIONS

Earnings Summary

Net income applicable to common shares was \$3,703,000 for 2011 compared to a net loss applicable to common shares of \$2,272,000 and \$790,000 for 2010 and 2009, respectively. On a per share basis, the income applicable to common shares was \$0.49 per diluted share in 2011, compared to a net loss per diluted share of \$0.31 and \$0.11 per diluted share in 2010 and 2009, respectively. Return on average equity was 4.55% in 2011 compared to (2.60%) in 2010 and (0.90%) in 2009. Return on average assets for the year ended December 31, 2011 was 0.28% compared to (0.15%) and (0.05%) in 2010 and 2009, respectively. Included in 2011's net income were \$4 million of realized securities gains, which partially offset writedowns of OREO properties to fair value of \$6.7 million and other-than-temporary non-cash impairment charges of \$2.6 million related to certain residential mortgage-backed securities, which we continue to own. A summary of the significant factors influencing our results of operations and related ratios is included in the following discussion.

Net Interest Income

The major component of our net earnings is net interest income, which is the excess of interest earned on earning assets over the interest expense incurred on interest bearing sources of funds. Net interest income is affected by changes in volume, resulting from growth and alterations of the balance sheet's composition, fluctuations in interest rates and maturities of sources and uses of funds. We seek to maximize net interest income through management of our balance sheet components. This is accomplished by determining the optimal product mix with respect to yields on assets and costs of funds in light of projected economic conditions, while maintaining portfolio risk at an acceptable level.

Net interest income on a fully tax equivalent basis average balance sheet amounts, and corresponding average yields on interest earning assets and costs of interest bearing liabilities for the years 2011, 2010 and 2009 are presented in Table I. Table II presents, for the periods indicated, the changes in interest income and expense attributable to (a) changes in volume (changes in volume multiplied by prior period rate) and (b) changes in rate (change in rate multiplied by prior period volume). Changes in interest income and expense attributable to both rate and volume have been allocated between the factors in proportion to the relationship of the absolute dollar amounts of the change in each.

Net interest income on a fully tax equivalent basis totaled \$41,369,000, \$41,222,000, and \$44,840,000 for the years ended December 31, 2011, 2010, and 2009, respectively, representing an increase of 0.4% in 2011 and a decrease of 8.1% in 2010. During 2011, the volumes of both interest earning assets and interest bearing liabilities declined, but these reductions were more than offset by lower yields on both interest earning assets and interest bearing liabilities. The 2010 decrease was driven by reductions in interest earning assets, reflecting significantly weak demand for new loans and planned reductions in our balance sheet made to enhance our capital ratios. Total average earning assets decreased 3.97% to \$1,342,905,000 at December 31, 2011 from \$1,398,452,000 at December 31, 2010. Total average interest bearing liabilities decreased 4.18% to \$1,281,841,000 at December 31, 2011, compared to \$1,337,816,000 at December 31, 2010. As identified in Table II, tax equivalent net interest income increased \$147,000 in 2011 and decreased \$3,618,000 during 2010.

Our net interest margin was 3.08% for 2011 compared to 2.95% and 2.96% for 2010 and 2009, respectively. Our net interest margin increased 13 basis points in 2011 and decreased 1 basis point in 2010. The continuing low interest rate environment throughout 2011 and 2010 has served to positively impact our net interest margin due to our liability sensitive balance sheet. During 2011, the cost of interest bearing liabilities decreased 52 basis points, which more

than offset the 37 basis point decrease in the yield on interest earning assets while the cost of interest bearing funds decreased 27 basis points in 2010, which virtually offset the 24 basis point reduction in the yield on interest earning assets. Late in third quarter 2010, and into fourth quarter 2010, we reduced or repriced over \$100 million of our higher-rate long-term borrowings which has had a favorable impact on our net interest margin by reducing our cost of funds. See Tables I and II for further details regarding changes in volumes and rates of average assets and liabilities and how those changes affect our net interest income.

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.

Table I - Average Distribution of Assets, Liabilities and Shareholders' Equity, Interest Earnings & Expenses, and Average Yields/Rates

Dollars in thousands	2011			2010			2009		
	Average Balances	Earnings/Expense	Yield/Rate	Average Balances	Earnings/Expense	Yield/Rate	Average Balances	Earnings/Expense	Yield/Rate
ASSETS									
Interest earning assets									
Loans, net of unearned interest									
(1) Taxable	\$987,315	\$58,911	5.97%	\$1,082,537	\$65,643	6.06%	\$1,184,571	\$71,405	6.03%
Tax-exempt									
(2)	5,105	402	7.87%	5,965	476	7.98%	8,045	665	8.27%
Securities									
Taxable	252,901	9,106	3.60%	253,529	11,922	4.70%	271,820	15,602	5.74%
Tax-exempt									
(2)	63,894	4,080	6.39%	40,048	2,670	6.67%	46,740	3,150	6.74%
Federal Funds sold and interest bearing deposits with other banks									
	33,690	72	0.21%	16,373	31	0.19%	1,335	13	0.97%
	\$1,342,905	\$72,571	5.40%	\$1,398,452	\$80,742	5.77%	\$1,512,511	\$90,835	6.01%
Noninterest earning assets									
Cash and due from banks									
	4,022			4,267			18,282		
Premises and equipment									
	22,620			23,742			23,646		
Other assets									
	118,408			104,907			60,656		
Allowance for loan losses									
	(18,161)			(19,226)			(18,293)		
Total assets	\$1,469,794			\$1,512,142			\$1,596,802		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Liabilities									
Interest bearing liabilities									
Interest bearing demand deposits									
	\$152,552	\$391	0.26%	\$147,513	\$583	0.40%	\$154,233	\$784	0.51%
Savings deposits	207,226	1,899	0.92%	188,233	2,323	1.23%	112,712	1,774	1.57%
Time deposits	601,925	15,983	2.66%	605,663	18,131	2.99%	632,988	22,407	3.54%
Short-term borrowings									
	4,238	8	0.19%	16,172	80	0.49%	99,497	573	0.58%
Long-term borrowings and subordinated debentures									
	315,900	12,921	4.09%	380,235	18,403	4.84%	429,481	20,457	4.76%
	\$1,281,841	\$31,202	2.43%	\$1,337,816	\$39,520	2.95%	\$1,428,911	\$45,995	3.22%
Noninterest bearing liabilities									

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Demand deposits	85,247	73,971	71,281
Other liabilities	8,474	9,597	8,666
Total liabilities	1,375,562	1,421,384	1,508,858
Shareholders' equity - preferred	4,738	3,519	3,519
Shareholders' equity - common	89,494	87,239	84,425
Total liabilities and shareholders' equity	\$1,469,794	\$1,512,142	\$1,596,802
Net Interest Earnings	\$41,369	\$41,222	\$44,840
Net Interest Margin	3.08%	2.95%	2.96%

(1) For purposes of this table, nonaccrual loans are included in average loan balances. Included in interest and fees on loans are loan fees of \$573,000, \$534,000, and \$890,000 for the years ended December 31, 2011, 2010 and 2009 respectively.

(2) For purposes of this table, interest income on tax-exempt securities and loans has been adjusted assuming an effective combined Federal and state tax rate of 34% for all years presented. The tax equivalent adjustment results in an increase in interest income of \$1,525,000, \$1,070,000, and \$1,298,000, for the years ended December 31, 2011, 2010 and 2009, respectively.

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

Dollars in thousands	2011 Versus 2010 Increase (Decrease) Due to Change in:			2010 Versus 2009 Increase (Decrease) Due to Change in:		
	Volume	Rate	Net	Volume	Rate	Net
Interest earned on:						
Loans						
Taxable	\$(5,696)	\$(1,036)	\$(6,732)	\$(6,185)	\$423	\$(5,762)
Tax-exempt	(68)	(6)	\$(74)	(167)	(22)	\$(189)
Securities						
Taxable	(30)	(2,786)	\$(2,816)	(999)	(2,681)	\$(3,680)
Tax-exempt	1,527	(117)	\$1,410	(446)	(34)	\$(480)
Federal funds sold and interest bearing deposits with other banks						
	37	4	41	36	(18)	18
Total interest earned on interest earning assets	(4,230)	(3,941)	(8,171)	(7,761)	(2,332)	(10,093)
Interest paid on:						
Interest bearing demand deposits						
	19	(211)	(192)	(33)	(168)	(201)
Savings deposits	217	(641)	(424)	995	(446)	549
Time deposits	(111)	(2,037)	(2,148)	(934)	(3,342)	(4,276)
Short-term borrowings	(39)	(33)	(72)	(422)	(71)	(493)
Long-term borrowings and subordinated debentures						
	(2,862)	(2,620)	(5,482)	(2,379)	325	(2,054)
Total interest paid on interest bearing liabilities	(2,776)	(5,542)	(8,318)	(2,773)	(3,702)	(6,475)
Net interest income	\$(1,454)	\$1,601	\$147	\$(4,988)	\$1,370	\$(3,618)

Noninterest Income

Noninterest income totaled 0.38%, 0.51%, and 0.39%, of average assets in 2011, 2010, and 2009, respectively. Noninterest income totaled \$5,550,000 in 2011 compared to \$7,739,000 in 2010, and \$6,281,000 in 2009, with insurance commissions, service fees from deposit accounts and realized securities gains being the primary positive components and other-than-temporary impairment of securities and writedowns of OREO properties being the largest negative components. Further detail regarding noninterest income is reflected in the following table.

Table III - Noninterest Income

Dollars in thousands	2011	2010	2009
Insurance commissions	\$ 4,461	\$ 4,744	\$ 5,045
	4,125	4,036	4,094

Service fees related to deposit accounts			
Mortgage origination revenue	208	186	265
Realized securities gains	4,006	2,051	1,497
Other-than-temporary impairment of securities	(2,646)	(988)	(5,366)
Gain (loss) on sale of assets	295	142	(112)
Bank owned life insurance income	846	517	481
Writedown of foreclosed properties	(6,651)	(3,401)	-
Other	906	452	377
Total	\$ 5,550	\$ 7,739	\$ 6,281

Insurance commissions: Insurance commissions have trended downward in 2011 and 2010 due to the continued recessionary economic environment. Employee benefit related products, the largest line generating our insurance commissions, have been negatively impacted by reductions in staff and benefits by our employer clients, thus reducing the commission that we earn, and also tightening of commission structures paid to us by our insurance carriers.

Other-than-temporary impairment of securities: During 2011 and 2010, we took other-than-temporary non-cash impairment charges of \$2.6 million and \$1.0 million, respectively, related to certain nongovernment sponsored residential mortgage-backed securities.

Writedown of foreclosed properties: During 2011 and 2010, we recognized \$6.7 million and \$3.4 million, respectively, in writedowns of OREO properties to record them at fair value less estimated costs to sell. Continued volatility in the real estate markets could result in further writedowns of these properties in the foreseeable future.

Gains/losses on sales of assets: These items are primarily a result of sales of foreclosed properties.

Noninterest Expense

Noninterest expense was well controlled in both 2011 and 2010. These expenses totaled \$30,285,000, \$31,470,000, and \$32,379,000, or 2.1%, 2.1%, and 2.0%, of average assets for each of the years ended December 31, 2011, 2010, and 2009, respectively. Total noninterest expense decreased \$1,186,000 in 2011 compared to 2010 and decreased \$908,000 in 2010 compared to 2009. Table IV below shows the breakdown of these increases.

Salaries and employee benefits: Salaries and employee benefits decreased 4.5% during 2010 compared to 2009. These decreases were primarily attributable to decreased performance-based incentive payments throughout the Company and reduction in staff.

Professional fees: Professional fees, consisting primarily of legal, accounting, and consulting fees, increased 13.8% during 2011 primarily due to increased fees related to complex collection issues relative to our problem assets. These fees decreased 28.0% during 2010 compared to 2009 as a result of fewer foreclosures during 2010. These fees were elevated in 2009 due to more foreclosures during 2009.

FDIC premiums: The decrease in FDIC premiums during 2011 is a result of the change in the assessment base used in calculating FDIC premiums that became effective during second quarter 2011. The decrease in 2010 was primarily attributable to the one-time special assessment during second quarter 2009.

Foreclosed properties expense: These expenses increased significantly during 2010 due to the increase in properties that we foreclosed upon during the period and the related expenses of owning those properties, including real property taxes, which accounted for 40% and 46% of total foreclosed properties expenses in 2011 and 2010, respectively.

Other: During 2011, other expenses declined primarily as a result of a refund of Virginia business franchise taxes. This refund is a result of OREO property taxes paid in Virginia being an allowable offset to taxable capital for business franchise tax calculation purposes.

Table IV - Noninterest Expense

Dollars in thousands	Change				Change			
	2011	\$	%	2010	\$	%	2009	
Salaries, commissions, and employee benefits	\$ 15,833	\$ 183	1.2 %	\$ 15,650	\$ (739)	-4.5 %	\$ 16,389	
Net occupancy expense	1,935	(75)	-3.7 %	2,010	(22)	-1.1 %	2,032	
Equipment expense	2,342	(115)	-4.7 %	2,457	306	14.2 %	2,151	
Supplies	324	(157)	-32.6 %	481	(486)	-50.3 %	967	
Professional fees	1,155	140	13.8 %	1,015	(394)	-28.0 %	1,409	
Advertising	157	9	6.1 %	148	(50)	-25.3 %	198	
Amortization of intangibles	351	-	0.0 %	351	-	0.0 %	351	
FDIC premiums	2,423	(447)	-15.6 %	2,870	(353)	-11.0 %	3,223	
Foreclosed properties expense	1,677	100	6.3 %	1,577	1,099	229.9 %	478	

Other	4,088	(824)	-16.8 %	4,912	(269)	-5.2 %	5,181
Total	\$ 30,285	\$ (1,186)	-3.8 %	\$ 31,471	\$ (908)	-2.8 %	\$ 32,379

Income Tax Expense/Benefit

Income tax expense for the year ended December 31, 2011 totaled \$1,035,000. Income tax benefit for the years ended December 31, 2010, and 2009 totaled (\$2,955,000), and (\$2,165,000), respectively. Refer to Note 12 of the accompanying consolidated financial statements for further information and additional discussion of the significant components influencing our effective income tax rates.

CHANGES IN FINANCIAL POSITION

Our average assets decreased during 2011 to \$1,469,794,000, a decrease of 2.8% below 2010's average of \$1,512,142,000, and our year end December 31, 2011 assets were \$27,449,000 less than December 31, 2010. Average assets decreased 5.3% in 2010, from \$1,596,802,000 in 2009. Significant changes in the components of our balance sheet in 2011 and 2010 are discussed below.

Loan Portfolio

Table V depicts gross loan balances by type and the respective percentage of each to total loans at December 31, as follows:

Table V - Loans by Type

Dollars in thousands	2011 Amount	Percent of Total	2010 Amount	Percent of Total	2009 Amount	Percent of Total	2008 Amount	Percent of Total	2007 Amount	Percent of Total
Commercial	\$99,101	10.1 %	\$97,261	9.6 %	\$122,508	10.6 %	\$130,106	10.7 %	\$92,599	8.7 %
Commercial real estate	429,531	43.5 %	423,011	41.7 %	465,037	40.2 %	452,264	37.3 %	384,478	36.1 %
Construction and development	96,013	9.8 %	112,840	11.1 %	162,080	14.1 %	215,465	17.9 %	225,270	21.3 %
Residential mortgage	334,688	34.0 %	352,328	34.7 %	372,867	32.2 %	376,026	31.0 %	322,640	30.3 %
Consumer	22,377	2.3 %	23,886	2.4 %	28,203	2.4 %	31,519	2.6 %	31,956	3.0 %
Other	2,765	0.3 %	4,840	0.5 %	5,652	0.5 %	6,061	0.5 %	6,641	0.6 %
Total loans	\$984,475	100.0%	\$1,014,166	100.0%	\$1,156,347	100.0%	\$1,211,441	100.0%	\$1,063,584	100.0%

Total net loans averaged \$992,420,000 in 2011 compared to \$1,088,502,000 in 2010, which represented nearly 68% and 72% of total average assets for each year, respectively. We have slowed our loan growth due to the current weakened economic conditions in our market areas and limited availability of new capital resources.

Refer to Note 5 of the accompanying consolidated financial statements for our loan maturities and a discussion of our adjustable rate loans as of December 31, 2011.

In the normal course of business, we make various commitments and incur certain contingent liabilities, which are disclosed in Note 14 of the accompanying consolidated financial statements but not reflected in the accompanying consolidated financial statements. There have been no significant changes in these types of commitments and contingent liabilities and we do not anticipate any material losses as a result of these commitments.

Securities

Securities comprised approximately 19.7% of total assets at December 31, 2011 compared to 18.4% at December 31, 2010. Average securities approximated \$316,795,000 for 2011 or 7.9% more than 2010's average of \$293,577,000. Refer to Note 4 of the accompanying consolidated financial statements for details of amortized cost, the estimated fair values, unrealized gains and losses as well as the security classifications by type.

All of our securities are classified as available for sale to provide us with flexibility to better manage our balance sheet structure and react to asset/liability management issues as they arise. Pursuant to ASC Topic 320 Investments—Debt and Equity Securities, anytime that we carry a security with an unrealized loss that has been determined to be “other-than-temporary”, we must recognize that loss in income. During 2011, 2010 and 2009, we took other-than-temporary non-cash impairment charges of \$2.6 million, \$1.0 million and \$5.4 million, respectively, related to certain nongovernment sponsored residential mortgage-backed securities.

At December 31, 2011, we had \$1.6 million in 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 collateral performance, we hold primarily senior tranches of each issue which provides protection against defaults. We attribute the unrealized loss on these mortgage backed securities largely due to their current absence of liquidity. We have the ability and intent to hold these investments until their fair value recovers or until maturity. The mortgages in these asset pools have been made to borrowers with acceptable credit history and significant equity invested in their homes. They are well diversified geographically. Nonetheless, significant 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 trigger the recognition of additional other-than-temporary impairment charges.

At December 31, 2011, we did not own securities of any one issuer that were not issued by the U.S. Treasury or a U.S. Government agency that exceeded ten percent of shareholders’ equity. The maturity distribution of the securities portfolio at December 31, 2011, together with the weighted average yields for each range of maturity, is summarized in Table VI. The stated average yields are actual yields and are not stated on a tax equivalent basis.

Table VI - Securities Maturity Analysis

(At amortized cost, dollars in thousands)	Within one year		After one but within five years		After five but within ten years		After ten years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U. S. Government agencies								
and corporations	\$ 743	4.6 %	\$ -	0.0 %	\$ 4,705	3.4 %	\$ 2,814	4.0 %
Residential mortgage backed securities:								
Government sponsored agencies	64,696	2.8 %	76,454	3.3 %	7,002	3.7 %	4,663	3.9 %
Nongovernment sponsored entities	8,030	5.5 %	17,995	6.0 %	3,995	6.9 %	5,226	7.3 %
Tax-exempt mortgage backed securities	-	0.0 %	-	0.0 %	-	-	3,109	3.8 %
State and political subdivisions	1,691	6.6 %	3,151	6.9 %	1,845	7.2 %	73,243	5.7 %
Corporate debt securities	-	-	-	-	999	6.0 %	-	-
Other	-	-	-	-	-	-	77	-
Total	\$ 75,160	3.2 %	\$ 97,600	3.9 %	\$ 18,546	4.8 %	\$ 89,132	5.6 %

Deposits

Total deposits at December 31, 2011 decreased \$20,439,000 or 2.0% compared to December 31, 2010. We have strengthened our focus on growing retail deposits, which is reflected by their continued growth over the past five years, increasing 5.0% in 2011 and 4.0% in 2010. Brokered deposits, which represent certificates of deposit acquired through a third party, decreased 26.5% to \$169,215,000 at December 31, 2011. These deposits totaled \$230,287,000 at December 31, 2010, a decrease of 4.8% from 2009. During 2011, 2010, and 2009, our focus on increasing retail deposits enabled us to lower our brokered deposits.

Table VII - Deposits

Dollars in thousands	2011	2010	2009	2008	2007
Noninterest bearing demand	\$ 88,655	\$ 74,604	\$ 74,119	\$ 69,808	\$ 65,727
Interest bearing demand	158,483	150,291	148,587	156,990	222,825
Savings	208,809	177,053	188,419	61,689	40,845
Certificates of deposit	353,275	367,040	328,858	347,444	291,294
	38,063	37,664	35,541	33,330	31,605

Individual Retirement Accounts					
Total retail deposits	847,285	806,652	775,524	669,261	652,296
Brokered deposits	169,215	230,287	241,814	296,589	176,391
Total deposits	\$ 1,016,500	\$ 1,036,939	\$ 1,017,338	\$ 965,850	\$ 828,687

See Table I for average deposit balance and rate information by deposit type for 2011, 2010 and 2009 and Note 10 of the accompanying consolidated financial statements for a maturity distribution of time deposits as of December 31, 2011.

Borrowings

Lines of Credit: We have remaining available lines of credit from the Federal Home Loan Bank totaling \$137,084,000 at December 31, 2011. We use these lines primarily to fund loans to customers. Funds acquired through this program are reflected on the consolidated balance sheet in short-term borrowings or long-term borrowings, depending on the repayment terms of the debt agreement. We also had \$90.1 million available on a short term line of credit with the Federal Reserve Bank at December 31, 2011, which is primarily secured by consumer loans, construction loans, farmland loans, and commercial and industrial loans.

Short-term Borrowings: Total short-term borrowings increased \$14,374,000 from \$1,582,000 at December 31, 2010 to \$15,956,000 at December 31, 2011. This increase was used principally to replace maturing brokered certificates of deposit. See Note 11 of the accompanying consolidated financial statements for additional disclosures regarding our short-term borrowings.

Long-term Borrowings: Total long-term borrowings of \$270,254,000 at December 31, 2011 and \$304,109,000 at December 31, 2010 consisted primarily of funds borrowed on available lines of credit from the Federal Home Loan Bank and structured reverse repurchase agreements with two unaffiliated institutions. Borrowings from the Federal Home Loan Bank totaled \$160,325,000 at December 31, 2011, compared to \$182,375,000 outstanding at December 31, 2010. We have a term loan with an unrelated financial institution that is secured by the common stock of our subsidiary bank, with an interest rate of prime minus 50 basis points, and matures in 2017. The outstanding balance of this term loan was \$9,929,000 at December 31, 2011 and \$11,734,000 at December 31, 2010. During 2007, we entered into \$110 million of structured reverse repurchase agreements, with terms ranging from 5 to 10 years and call features ranging from 2 to 3.5 years in which they are callable by the purchaser. Long term borrowings were principally used to fund our loan growth. These structured reverse repurchase agreements totaled \$100,000,000 at December 31, 2011. Refer to Note 11 of the accompanying consolidated financial statements for additional information regarding our long-term borrowings.

Subordinated Debentures: We have subordinated debt totaling \$16.8 million at December 31, 2011 and 2010. Subordinated debt qualifies as Tier 2 regulatory capital until the debt is within 5 years of maturity, at which time, the qualifying amount is decreased 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, have a term of 10 years, and are not prepayable by us within the first five years. During 2008, \$10 million of subordinated debt was issued to an unrelated institution, which bears a variable interest rate of 1 month LIBOR plus 275 basis points, has a term of 7.5 years.

ASSET QUALITY

Due to continued recessionary economic conditions, borrowers have in many cases been unable to refinance their loans due to a range of factors including declining property values. 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.

Table VIII presents a summary of non-performing assets at December 31, as follows:

Table VIII -
Nonperforming
Assets

Dollars in thousands	2011	2010	2009	2008	2007
Accruing loans past due 90 days or more:					
Commercial	\$ -	\$ -	\$ 23	\$ -	\$ 702
Commercial real estate	-	-	-	-	2,821
Commercial construction & development	-	-	-	1,015	-
Residential construction & development	344	-	-	-	1,919
Residential real estate	-	1,442	156	2	1,765
Consumer	-	-	20	22	209
Other	-	-	2	-	-
Total 90+ days past due	344	1,442	201	1,039	7,416
Nonaccrual loans:					
Commercial	3,260	1,318	408	198	14
Commercial real estate	7,163	2,686	35,217	24,323	1,524
	1,052	-	11,553	-	-

Commercial construction & development										
Residential construction & development	22,289	10,049	14,775	17,368	98					
Residential real estate	18,187	6,075	4,407	4,983	1,247					
Consumer	145	141	381	58	34					
Total nonaccrual loans	52,096	20,269	66,741	46,930	2,917					
Foreclosed properties:										
Commercial	-	597	-	-	-					
Commercial real estate	15,721	14,745	4,788	875	430					
Commercial construction & development	17,101	17,021	2,028	180	525					
Residential construction & development	27,877	34,377	30,230	6,575	391					
Residential real estate	3,239	3,495	3,247	480	712					
Consumer	-	-	-	-	-					
Total foreclosed properties	63,938	70,235	40,293	8,110	2,058					
Repossessed assets	263	289	269	3	-					
Total nonperforming assets	\$ 116,641	\$ 92,235	\$ 107,504	\$ 56,082	\$ 12,391					
Total nonperforming loans as a percentage of total loans	5.33	% 2.14	% 5.79	% 3.97	% 0.97					
Total nonperforming assets as a percentage of total assets	8.04	% 6.24	% 6.78	% 3.45	% 0.86					

The following table details our most significant nonperforming loan relationships at December 31, 2011.

Table IX - Significant Nonperforming Loan Relationships

December 31, 2011

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
Rockingham Co., VA	Residential subdivision	Nov. 2007 & Dec. 2009	Mar. 2009 & Apr. 2011	\$ 1,994	Collateral value	\$ 2,223	(1)	\$ -	\$ 904
Hardy Co., WV	Residential subdivision & building lots	Apr. 2008	Dec. 2011	\$ 1,302	Collateral value	\$ 1,827	(1)	\$ 389	\$ -
Rockingham Co., VA	Residential subdivision	Jun. 2009	Nov. 2011	\$ 1,600	Collateral value	\$ 1,668	(1)	\$ 99	\$ 714
Shenandoah Co., VA	Residential subdivision	Sept. 2005	Dec. 2011	\$ 1,931	Collateral value	\$ 1,451	(1)	\$ 625	\$ -
Rockingham Co., VA	Convenience store	Apr. 2004	Mar. 2011	\$ 1,011	Collateral value	\$ 2,200	(1)	\$ -	\$ -
Shenandoah Co., & Frederick Co., VA	Residential building lots	Aug. 2004, July 2005, & July 2007	Jun. 2011	\$ 2,137	Collateral value	\$ 2,020	(1)	\$ 381	\$ -
Faquier Co., VA	Single family residence & business investment	Aug. 2007, Oct. 2007 & Sept. 2008	Dec. 2011	\$ 12,621	Collateral value	\$ 16,714	(1)	\$ -	\$ -
Frederick Co., VA	Single family residence	Sept. 2010	Jun. 2011	\$ 1,345	Collateral value	\$ 1,350	(1)	\$ 130	\$ 100
Frederick Co., VA	Mini Storage facility	Mar. 2010	Jun. 2011	\$ 1,752	Collateral value	\$ 1,791	(1)	\$ 140	\$ -
Jefferson Co., WV	Residential development & undeveloped acreage	Mar. 2008 & June 2008	Jun. 2011	\$ 8,378	Collateral value	\$ 9,666	(1)	\$ 771	\$ -
Rockingham Co., VA	Residential subdivision & 2 single family residential	Jun. 2008	Sept. 2011	\$ 2,166	Collateral value	\$ 1,792	(1)	\$ 534	\$ -

	building lots								
	UCC business								
	assets &	Feb. 2003,							
Kanawha	residential	Mar. 2008	May 2011		Collateral				
Co., WV	subdivision	& Apr. 2008	& Jul. 2011	\$ 1,246	value	\$ 1,653	(2)	\$ 31	\$ -

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

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

At December 31, 2011, we had approximately \$4.1 million of performing loans which we have identified as potential problem loans. Known information about possible credit problems of the related borrowers causes management to have concerns as to the ability of such borrowers to comply with the current loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, or require increased allowance coverage and provision for loan losses.

Refer to Note 5, Loans, for information regarding our past due loans.

We monitor our concentrations in higher-risk lending areas in accordance with the Interagency Guidance for Concentrations in Commercial Real Estate Lending issued in 2006. This guidance establishes concentration guidelines of 100% of Tier 1 Capital plus the allowance for loan and lease loss for lending in construction, land development, and other land loans. It further establishes a guideline of 300% of Tier 1 Capital plus the allowance for loan and lease loss for lending in construction, land development and other land loans plus loans secured by non-owner occupied non-farm non-residential properties. As of December 31, 2011, Summit Community Bank was within the recommended limits of 100% and 300%, respectively.

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

Specific Reserve for Loans Individually Evaluated

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

Fluctuations in Components of the Allowance

Over the past year the components of the allowance have remained consistent. The specific reserve for loans individually evaluated for impairment was \$4,746,000 at December 31, 2011 compared to \$4,875,000 at December 31, 2010.

The FAS 5 (ASC Topic 450 – Contingencies) or pool reserve totaled \$12,966,000 as of December 31, 2011 compared to \$12,349,000 as of December 31, 2010.

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

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

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

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

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 December 31, 2011, approximately 61% of our impaired loans required no reserves or have been charged down to their fair value. Accordingly, our allowance for loan losses has not increased proportionately as our nonperforming loans have increased. The allowance for loan loss will, however, increase as a result of an increase in net loan charge-offs due to the incremental higher historical net charge-off rate applied to the loans which are collectively evaluated for impairment.

At December 31, 2011 and 2010, our allowance for loan losses totaled \$17,712,000, or 1.80% of total loans and \$17,224,000, or 1.70% of total loans, respectively, and is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio. Table XI presents an allocation of the allowance for loan losses by loan type at each respective year end date, as follows:

Table XI - Allocation of the Allowance for Loan Losses

Dollars in thousands	2011			2010			2009			2008			2007		
	Amount	% of loans in each category to total		Amount	% of loans in each category to total		Amount	% of loans in each category to total		Amount	% of loans in each category to total		Amount	% of loans in each category to total	
Commercial	\$770	10.1 %		\$323	9.6 %		\$401	10.6 %		\$546	10.7 %		\$543	8.7 %	
Commercial real estate	4,618	43.6 %		4,049	41.7 %		3,938	40.2 %		4,705	37.4 %		3,254	36.1 %	
Construction and development	7,381	9.8 %		8,182	11.1 %		8,747	14.0 %		7,536	17.8 %		2,668	21.2 %	
Residential real estate	4,749	34.0 %		4,376	34.7 %		3,626	32.3 %		3,458	31.0 %		1,991	30.4 %	
Consumer	161	2.3 %		263	2.4 %		249	2.4 %		427	2.6 %		451	3.0 %	
Other	33	0.2 %		31	0.5 %		39	0.5 %		261	0.5 %		285	0.6 %	
Unallocated	-	0.0 %		-	0.0 %		-	0.0 %		-	-		-	-	
	\$17,712	100.0 %		\$17,224	100.0 %		\$17,000	100.0 %		\$16,933	100.0 %		\$9,192	100.0 %	

A reconciliation of the activity in the allowance for loan losses follows:

Table XII - Allowance for
Loan Losses

Dollars in thousands	2011	2010	2009	2008	2007
Balance, beginning of year	\$ 17,224	\$ 17,000	\$ 16,933	\$ 9,192	\$ 7,511
Losses:					
Commercial	506	601	479	198	50
Commercial real estate	586	9,239	469	1,131	154
Construction and development	3,568	7,937	16,946	4,529	80
Residential real estate	5,035	3,836	3,921	1,608	618
Consumer	162	279	214	375	216
Other	86	233	231	203	160
Total	9,943	22,125	22,260	8,044	1,278
Recoveries:					
Commercial	35	38	129	4	2
Commercial real estate	92	273	23	17	13
Construction and development	43	331	1,615	-	20
Residential real estate	98	164	29	64	15
Consumer	112	87	90	72	58
Other	51	106	116	128	104
Total	431	999	2,002	285	212
Net losses	9,512	21,126	20,258	7,759	1,066
Provision for loan losses	10,000	21,350	20,325	15,500	2,055
Reclassification of reserves related to loans previously reflected in discontinued operations	-	-	-	-	692
Balance, end of year	\$ 17,712	\$ 17,224	\$ 17,000	\$ 16,933	\$ 9,192

At December 31, 2011 and 2010, we had approximately \$63,938,000 and \$69,638,000, 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.

LIQUIDITY AND CAPITAL RESOURCES

Bank Liquidity: 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, which totaled approximately \$196,111,000 or 13.5% of total consolidated assets at December 31, 2011.

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. Core deposits increased \$40.6 million in 2011, while loans decreased approximately \$29 million. This allowed us to pay down long term FHLB borrowings, and to reduce our brokered certificates of deposit by not renewing them at maturity. As a member of the Federal Home Loan Bank of Pittsburgh, we have access to approximately \$312 million. As of December 31, 2011 and 2010, these advances totaled approximately \$160 million and \$182 million, respectively. At December 31, 2011, we had additional borrowing capacity of \$137 million through FHLB programs. We have established a line with the Federal Reserve Bank to be used as a contingency liquidity vehicle. The amount available on this line at December 31, 2011 was approximately \$90 million, which is secured by a pledge of our consumer and commercial and industrial loan portfolios. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises.

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

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

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

- Would have limited amounts of maturing brokered deposits to replace in the short-term, as we have limited our brokered deposits maturing in any one quarter to no more than \$50 million.
- Presently has \$286 million in available sources of liquid funds which could be drawn upon to fund maturing brokered deposits until Summit Community had restored its capital to well capitalized status.

- Would first seek to restore its capital to well capitalized status through capital contributions from Summit, its parent holding company. Summit has present cash reserves in excess of \$8 million available for capital infusion into Summit Community.
- Would generally have no more than \$100 million in brokered deposits maturing in any one year time frame, which is well within its presently available sources of liquid funds, if in the event Summit does not have the capital resources to restore Summit Community's capital to well capitalized status. One year would give Summit Community ample time to raise alternative funds either through retail deposits or the sale of assets, and obtain capital resources to restore it to well capitalized status.

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

- Would severely curtail lending and other growth activities until such time as access to this line could be restored, thus eliminating the need for net new advances.
 - Would still have available current liquid funding sources totaling \$141 million aside from its FHLB line and,
- In addition, would have available currently almost \$74 million unpledged government agency securities (debentures and mortgage backed securities) that are available for use in repurchase arrangements with institutional broker and would result in a funding source of at least \$60 million to meet unforeseen liquidity needs.

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

- Presently has \$286 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.

Growth and Expansion: During 2011, we spent approximately \$0.4 million on capital expenditures for premises and equipment. We expect our capital expenditures to approximate \$0.5 million in 2012, primarily for equipment upgrades.

Management anticipates that the Company’s near term level of assets will remain stable or even decline slightly in comparison with that of recent prior years due to the present recessionary economic environment.

Capital Compliance: Our capital position has significantly improved. This is primarily attributable to an increase in retained earnings due to our return to profitability in 2011, a decline in total assets, and various capital raises over the past three years. Stated as a percentage of total assets, our equity ratio was 7.1% and 6.1% at December 31, 2011 and 2010, respectively. At December 31, 2011, we had Tier 1 risk-based, Total risk-based and Tier 1 leverage capital in excess of the minimum levels required to be considered “well capitalized” of \$47.3 million, \$31.5 million, and \$37.5 million, respectively. Our subsidiary bank, Summit Community Bank, had Tier 1 risk-based, Total risk-based and Tier 1 leverage capital in excess of the minimum “well capitalized” levels of \$66.4 million, \$37.8 million, and \$56.6 million, respectively. We intend to maintain both Summit’s and its subsidiary bank’s capital ratios at levels that would be considered to be “well capitalized” in accordance with regulatory capital guidelines. See Note 16 of the accompanying consolidated financial statements for further discussion of our regulatory capital.

During 2009, we issued \$6.8 million in subordinated debentures, 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, have a term of 10 years, and are not prepayable by us within the first five years. During 2008, we issued \$10 million of subordinated debentures. This debt has an interest rate of 1 month LIBOR plus 275 basis points, a term of 7.5 years, and is not prepayable by us within the first two and a half years. These subordinated debentures qualify as Tier 2 capital until they are within 5 years of maturity, thereafter the amount qualifying as Tier 2 capital is reduced by 20 percent each year until maturity.

On September 30, 2009, we issued \$3.7 million of 8% non-cumulative convertible preferred stock and during fourth quarter 2011, we issued an additional \$5.8 million of 8% non-cumulative convertible preferred stock.

Issuance of Trust Preferred Securities: Under Federal Reserve Board guidelines, we had the ability to issue an additional \$11.7 million of trust preferred securities as of December 31, 2011 that would qualify as Tier 1 regulatory capital to support our future growth. Trust preferred securities issuances in excess of this limit generally may be included in Tier 2 capital.

Dividends: There were no cash dividends paid on common shares in 2011 or 2010. Future cash dividends will depend on the earnings, and financial condition of our subsidiary bank and our capital adequacy as well as general economic conditions. As discussed below under Regulatory Matters, we are presently restricted from paying cash dividends on our common stock.

The primary source of funds for the dividends paid to our shareholders is dividends received from our subsidiary bank. Dividends paid by our subsidiary bank are subject to restrictions by banking law and regulations and require approval by the bank's regulatory agency if dividends declared in any year exceed the bank's current year's net income, as defined, plus its retained net profits of the two preceding years. Presently, as a result of the current bank MOU, the bank is required to give 30 days prior written notice of its intent to pay any cash dividends to its regulatory authorities to give regulatory authorities an opportunity to object.

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

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

The Bank MOU was amended effective February 1, 2011, to include additional requirements that management:

- Review overall liquidity objectives and develop and submit to regulatory authorities plans and procedures aimed to improve liquidity and reduce reliance on volatile liabilities; and
- Perform a risk segmentation analysis of concentrations of credit and develop plan to reduce any segment of the portfolio which regulatory authorities deem to be an undue concentration of credit.

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

Contractual Cash Obligations: During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at December 31, 2011.

Table XIII - Contractual Cash Obligations

Dollars in thousands	Long Term Debt and Subordinated Debentures	Operating Leases
2012	\$ 67,437	\$ 243
2013	41,898	235
2014	83,429	175
2015	11,909	21
2016	1,911	-
Thereafter	100,059	-
Total	\$ 306,643	\$ 674

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 December 31, 2011 are presented in the following table. Refer to Note 14 of the accompanying consolidated financial statements for further discussion of our off-balance sheet arrangements.

Table XIV - Off-Balance Sheet Arrangements

Dollars in thousands

Commitments to extend credit

Revolving home
equity and

credit card lines	\$	45,660
Construction loans		11,893
Other loans		33,139
Standby letters of credit		1,489
Total	\$	92,181

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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 embedded 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”). The ALCO 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. At December 31, 2011, our interest rate risk position was liability sensitive. That is, liabilities are likely to reprice faster than assets, resulting in a decrease in net interest income in a rising rate environment, while a falling interest rate environment would produce an increase in net interest income. Net interest income is also subject to changes in the shape of the yield curve. In general, a flat yield curve results 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 rates is assumed to gradually take place over a 12 month period, 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 December 31, 2011. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable thereafter for the up and down 100 and the up 200 scenarios, and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above and are well within our ALCO policy limit, which is a 10% reduction in net interest income over the ensuing twelve month period.

Change in Interest Rates basis points	Estimated % Change in Net Interest Income Over:	
	0 - 12 Months	13 - 24 Months
	1.42%	7.17%

Down		
100 (1)		
Up 100		
(1)	-2.14%	0.10%
Up 200		
(1)	-4.29%	-2.81%
Up 400		
(2)	-4.29%	-4.03%

(1) assumes a parallel shift in the yield curve over 12 months

(2) assumes a parallel shift in the yield curve over 24 months

REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

Summit Financial Group, Inc. is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

We, as management of Summit Financial Group, Inc., are responsible for establishing and maintaining effective internal control over financial reporting that is designed to produce reliable financial statements in conformity with United States generally accepted accounting principles and in conformity with the Federal Financial Institutions Examination Council instructions for consolidated Reports of Condition and Income (call report instructions). The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

The Audit Committee, consisting entirely of independent directors, meets regularly with management, internal auditors and the independent registered public accounting firm, and reviews audit plans and results, as well as management's actions taken in discharging responsibilities for accounting, financial reporting, and internal control. Arnett & Foster, P.L.L.C., independent registered public accounting firm, and the internal auditors have direct and confidential access to the Audit Committee at all times to discuss the results of their examinations.

Management assessed the Corporation's system of internal control over financial reporting as of December 31, 2011. In making this assessment, we used the criteria for effective internal control over financial reporting set forth in Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concludes that, as of December 31, 2011, its system of internal control over financial reporting is effective and meets the criteria of the Internal Control-Integrated Framework. Arnett & Foster, P.L.L.C., independent registered public accounting firm, has issued an attestation report on management's assessment of the Corporation's internal control over financial reporting.

Management is also responsible for compliance with the federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations.

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

/s/ Julie R. Cook
Senior Vice President
and Chief Accounting Officer

/s/ Robert S.
Vice President
and Chief Financial

Moorefield, West Virginia
March 1, 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON EFFECTIVENESS OF
INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Shareholders
Summit Financial Group, Inc.
Moorefield, West Virginia

We have audited Summit Financial Group, Inc.'s and subsidiaries internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Summit Financial Group, Inc.'s and subsidiaries management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report of Management's Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards established by the Public Company Accounting Oversight Board (United States). Those standards required that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Summit Financial Group, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based upon the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the financial statements of Summit Financial Group, Inc. and our report, dated March 1, 2012, expressed an

unqualified opinion.

Charleston, West Virginia
March 1, 2012

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Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Summit Financial Group, Inc.
Moorefield, West Virginia

We have audited the accompanying consolidated balance sheets of Summit Financial Group, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Summit Financial Group, Inc. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Summit Financial Group, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 1, 2012, expressed an unqualified opinion on the effectiveness of Summit Financial Group Inc's internal control over financial reporting.

Charleston, West Virginia
March 1, 2012

Consolidated Balance Sheets

Dollars in thousands	December 31,	
	2011	2010
ASSETS		
Cash and due from banks	\$4,398	\$4,652
Interest bearing deposits with other banks	28,294	45,696
Securities available for sale	286,599	271,730
Other investments	19,146	22,941
Loan held for sale, net	-	343
Loans, net	965,516	995,319
Property held for sale	63,938	69,638
Premises and equipment, net	22,084	23,092
Accrued interest receivable	5,784	5,879
Intangible assets	8,651	9,002
Cash surrender value of life insurance policies	29,284	13,458
Other assets	16,427	15,820
Total assets	\$1,450,121	\$1,477,570
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Non-interest bearing	\$88,655	\$74,604
Interest bearing	927,845	962,335
Total deposits	1,016,500	1,036,939
Short-term borrowings	15,956	1,582
Long-term borrowings	270,254	304,109
Subordinated debentures	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589
Other liabilities	8,456	8,730
Total liabilities	1,347,555	1,387,749
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock and related surplus, \$1.00 par value; authorized 250,000 shares:		
Series 2009, 8% Non-cumulative convertible preferred stock, par value \$1.00; issued 3,710 shares	3,519	3,519
Series 2011, 8% Non-cumulative convertible preferred stock, par value \$1.00; 2011 - 12,000 shares issued	5,807	-
Common stock and related surplus, \$2.50 par value; authorized 20,000,000 shares; issued 7,425,472 shares	24,518	24,508
Retained earnings	64,904	61,201
Accumulated other comprehensive income	3,818	593

Total shareholders' equity	102,566	89,821
Total liabilities and shareholders' equity	\$1,450,121	\$1,477,570

See Notes to Consolidated Financial Statements

Consolidated Statements of Income

Dollars in thousands (except per share amounts)	For the Year Ended December 31,		
	2011	2010	2009
Interest income			
Interest and fees on loans			
Taxable	\$58,910	\$65,643	\$71,405
Tax-exempt	265	314	439
Interest and dividends on securities			
Taxable	9,105	11,922	15,601
Tax-exempt	2,694	1,762	2,079
Interest on interest bearing deposits with other banks	72	31	12
Total interest income	71,046	79,672	89,536
Interest expense			
Interest on deposits	18,273	21,036	24,951
Interest on short-term borrowings	7	80	573
Interest on long-term borrowings and subordinated debentures	12,922	18,404	20,470
Total interest expense	31,202	39,520	45,994
Net interest income	39,844	40,152	43,542
Provision for loan losses	10,000	21,350	20,325
Net interest income after provision for loan losses	29,844	18,802	23,217
Noninterest income			
Insurance commissions	4,461	4,744	5,045
Service fees related to deposit accounts	4,125	4,036	3,996
Realized securities gains	4,006	2,051	1,497
Gain (loss) on sale of assets	295	142	(112)
Write-down of foreclosed properties	(6,651)	(3,401)	-
Bank owned life insurance income	846	517	481
Other	1,114	638	740
Total other-than-temporary impairment loss on securities	(6,279)	(1,816)	(5,892)
Portion of loss recognized in other comprehensive income	3,633	828	526
Net impairment loss recognized in earnings	(2,646)	(988)	(5,366)
Total noninterest income	5,550	7,739	6,281
Noninterest expenses			
Salaries, commissions, and employee benefits	15,833	15,650	16,389
Net occupancy expense	1,935	2,010	2,032
Equipment expense	2,342	2,457	2,151
Professional fees	1,155	1,015	1,409
Amortization of intangibles	351	351	351
FDIC premiums	2,423	2,870	3,223
Foreclosed properties expense	1,677	1,577	478
Other	4,569	5,541	6,346
Total noninterest expenses	30,285	31,471	32,379
Income (loss) before income tax expense	5,109	(4,930)	(2,881)
Income tax expense (benefit)	1,035	(2,955)	(2,165)
Net income (loss)	4,074	(1,975)	(716)
Dividends on preferred shares	371	297	74

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Net income (loss) applicable to common shares	\$3,703	\$(2,272) \$(790)
Basic earnings per common share	\$0.50	\$(0.31) \$(0.11)
Diluted earnings per common share	\$0.49	\$(0.31) \$(0.11)

See Notes to Consolidated Financial Statements

Consolidated Statements of Shareholders' Equity
For the Years Ended December 31, 2011, 2010 and 2009

Dollars in thousands (except per share amounts)	Series 2009	Series 2011	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Preferred Stock and Related Surplus	Preferred Stock and Related Surplus				
Balance, December 31, 2008	\$ -	\$ -	\$ 24,453	\$ 64,709	\$ (1,918)	\$ 87,244
Comprehensive income:						
Net loss	-	-	-	(716)	-	(716)
Other comprehensive income:						
Non-credit related other-than-temporary impairment on debt securities of \$526, net of deferred tax benefit of \$195	-	-	-	-	(326)	(326)
Net unrealized loss on securities of \$2,263, net of deferred tax benefit of \$860 and reclassification adjustment for gains included in net income of \$1,497	-	-	-	-	1,403	1,403
Total comprehensive income						361
Exercise of stock options	-	-	55	-	-	55