

SUMMIT FINANCIAL GROUP INC  
Form 10-Q  
November 02, 2018  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10 – Q

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

For the quarterly period ended September 30, 2018

or

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

Commission File Number 0-16587

Summit Financial Group, Inc.

(Exact name of registrant as specified in its charter)

West Virginia 55-0672148

(State or other jurisdiction of (IRS Employer incorporation or organization) Identification No.)

300 North Main Street

Moorefield, West Virginia 26836

(Address of principal executive offices) (Zip Code)

(304) 530-1000

(Registrant's telephone number, including area code)

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

Yes ☐ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yes ☐ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐

Smaller reporting company ☐ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

Yes ☐ No ☐

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

Common Stock, \$2.50 par value

12,474,062 shares outstanding as of October 31, 2018

---

Table of Contents

	Page
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	
Consolidated balance sheets September 30, 2018 (unaudited) and December 31, 2017	<u>3</u>
Consolidated statements of income for the three months and nine months ended September 30, 2018 and 2017 (unaudited)	<u>4</u>
Consolidated statements of comprehensive income for the three months and nine months ended September 30, 2018 and 2017 (unaudited)	<u>5</u>
Consolidated statements of shareholders' equity for the nine months ended September 30, 2018 and 2017 (unaudited)	<u>6</u>
Consolidated statements of cash flows for the nine months ended September 30, 2018 and 2017 (unaudited)	<u>7</u>
Notes to consolidated financial statements (unaudited)	<u>9</u>
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	<u>42</u>
Item 3. Quantitative and Qualitative Disclosures about Market Risk	<u>54</u>
Item 4. Controls and Procedures	<u>55</u>
<b>PART II. OTHER INFORMATION</b>	
Item 1. Legal Proceedings	<u>56</u>
Item 1A. Risk Factors	<u>56</u>
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	None
Item 3. Defaults upon Senior Securities	None
Item 4. Mine Safety Disclosures	None
Item 5. Other Information	None
Item 6. Exhibits	<u>56</u>
<b>EXHIBIT INDEX</b>	<u>57</u>

SIGNATURES

58

2

---

## Item 1. Financial Statements

## Consolidated Balance Sheets (unaudited)

	September 30, 2018 (unaudited)	December 31, 2017 (*)
Dollars in thousands, except per share amounts		
<b>ASSETS</b>		
Cash and due from banks	\$ 9,382	\$ 9,641
Interest bearing deposits with other banks	44,452	42,990
Cash and cash equivalents	53,834	52,631
Securities available for sale	288,040	328,723
Other investments	14,232	14,934
Loans held for sale	348	—
Loans, net	1,632,747	1,593,744
Property held for sale	22,017	21,470
Premises and equipment, net	36,888	34,209
Accrued interest receivable	8,630	8,329
Goodwill and other intangible assets	26,252	27,513
Cash surrender value of life insurance policies	42,208	41,358
Other assets	13,531	11,329
Total assets	\$ 2,138,727	\$ 2,134,240
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities		
Deposits		
Non interest bearing	\$ 232,697	\$ 217,493
Interest bearing	1,418,367	1,383,108
Total deposits	1,651,064	1,600,601
Short-term borrowings	238,403	250,499
Long-term borrowings	739	45,751
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589
Other liabilities	15,376	16,295
Total liabilities	1,925,171	1,932,735
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, \$1.00 par value, authorized 250,000 shares	—	—
Common stock and related surplus, \$2.50 par value; authorized 20,000,000 shares; issued: 2018 - 12,474,062 shares and 2017 - 12,465,296 shares; outstanding: 2018 - 12,382,450 shares and 2017 - 12,358,562	81,822	81,098
Unallocated common stock held by Employee Stock Ownership Plan - 2018 - 91,612 shares and 2017 - 106,734 shares	(989)	) (1,152 )
Retained earnings	135,628	119,827
Accumulated other comprehensive (loss) income	(2,905)	) 1,732
Total shareholders' equity	213,556	201,505

Total liabilities and shareholders' equity	\$ 2,138,727	\$ 2,134,240
--	--------------	--------------

(\*) - Derived from audited consolidated financial statements

See Notes to Consolidated Financial Statements

[Table of Contents](#)

3

---

## Consolidated Statements of Income (unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Dollars in thousands, (except per share amounts)				
Interest income				
Interest and fees on loans				
Taxable	\$21,154	\$19,387	\$62,196	\$54,487
Tax-exempt	141	103	428	391
Interest and dividends on securities				
Taxable	1,227	1,283	3,838	3,742
Tax-exempt	1,140	1,114	3,222	2,855
Interest on interest bearing deposits with other banks	138	149	412	466
Total interest income	23,800	22,036	70,096	61,941
Interest expense				
Interest on deposits	4,714	2,963	12,572	7,987
Interest on short-term borrowings	1,437	1,160	4,084	3,233
Interest on long-term borrowings and subordinated debentures	436	681	1,695	2,012
Total interest expense	6,587	4,804	18,351	13,232
Net interest income	17,213	17,232	51,745	48,709
Provision for loan losses	500	375	1,750	875
Net interest income after provision for loan losses	16,713	16,857	49,995	47,834
Noninterest income				
Insurance commissions	1,062	1,043	3,188	3,000
Trust and wealth management fees	687	589	2,026	1,284
Service charges on deposit accounts	1,215	1,162	3,421	2,910
Bank card revenue	793	738	2,343	1,955
Realized securities gains, net	8	26	828	58
Bank owned life insurance income	250	255	773	758
Other	196	187	656	531
Total noninterest income	4,211	4,000	13,235	10,496
Noninterest expenses				
Salaries, commissions and employee benefits	6,806	6,610	20,550	18,555
Net occupancy expense	856	847	2,528	2,239
Equipment expense	1,118	1,093	3,271	2,859
Professional fees	503	373	1,222	1,012
Advertising and public relations	170	137	461	393
Amortization of intangibles	413	448	1,261	974
FDIC premiums	210	310	690	815
Bank card expense	384	395	1,080	1,113
Foreclosed properties expense, net of losses	169	233	843	824
Litigation settlement	—	—	—	9,900
Merger-related expenses	86	11	86	1,575
Other	1,643	1,990	5,415	5,140
Total noninterest expenses	12,358	12,447	37,407	45,399
Income before income tax expense	8,566	8,410	25,823	12,931
Income tax expense	1,667	2,480	5,201	3,339
Net income	\$6,899	\$5,930	\$20,622	\$9,592

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

Basic earnings per common share	\$0.56	\$0.48	\$1.67	\$0.81
Diluted earnings per common share	\$0.55	\$0.48	\$1.66	\$0.81

See Notes to Consolidated Financial Statements

Table of Contents

4

---



## Consolidated Statements of Comprehensive Income (unaudited)

	For the Three Months Ended September 30,	
Dollars in thousands	2018	2017
Net income	\$6,899	\$5,930
Other comprehensive (loss) income:		
Net unrealized gain on cashflow hedge of:		
2018 - \$336, net of deferred taxes of \$81; 2017 - \$497, net of deferred taxes of \$184	255	313
Net unrealized (loss) gain on securities available for sale of:		
2018 - (\$2,861), net of deferred taxes of (\$687) and reclassification adjustment for net realized gains included in net income of \$8, net of tax of \$2; 2017 - \$608, net of deferred taxes of \$225 and reclassification adjustment for net realized gains included in net income of \$26, net of tax of \$10	(2,174 )	383
Total other comprehensive (loss) income	(1,919 )	696
Total comprehensive income	\$4,980	\$6,626
	For the Nine Months Ended September 30,	
Dollars in thousands	2018	2017
Net income	\$20,622	\$9,592
Other comprehensive (loss) income:		
Net unrealized gain on cashflow hedge of:		
2018 - \$1,772, net of deferred taxes of \$425; 2017 - \$1,556, net of deferred taxes of \$576	1,347	980
Net unrealized (loss) gain on securities available for sale of:		
2018 - (\$7,873), net of deferred taxes of (\$1,889) and reclassification adjustment for net realized gains included in net income of \$828, net of tax of \$199; 2017 - \$3,892, net of deferred taxes of \$1,440 and reclassification adjustment for net realized gains included in net income of \$58, net of tax of \$21	(5,984 )	2,452
Net unrealized gain on other post-retirement benefits of:		
2017 - \$348, net of deferred taxes of \$129	—	219
Total other comprehensive (loss) income	(4,637 )	3,651
Total comprehensive income	\$15,985	\$13,243

See Notes to Consolidated Financial Statements

Table of Contents

5

---

## Consolidated Statements of Shareholders' Equity (unaudited)

Dollars in thousands (except per share amounts)	Common Stock and Related Surplus	Unallocated Common Stock Held by ESOP	Retained Earnings	Accumulated Other Compre- hensive (Loss) Income	Total Share- holders' Equity
Balance, December 31, 2017	\$ 81,098	\$ (1,152 )	\$ 119,827	\$ 1,732	\$ 201,505
Nine Months Ended September 30, 2018					
Net income	—	—	20,622	—	20,622
Other comprehensive loss	—	—	—	(4,637 )	(4,637 )
Exercise of stock options - 1,600 shares	29	—	—	—	29
Share-based compensation expense	292	—	—	—	292
Unallocated ESOP shares committed to be released - 15,122 shares	224	163	—	—	387
Common stock issuances from reinvested dividends - 7,166 shares	179	—	—	—	179
Common stock cash dividends declared (\$0.39 per share)	—	—	(4,821 )	—	(4,821 )
Balance, September 30, 2018	\$ 81,822	\$ (989 )	\$ 135,628	\$ (2,905 )	\$ 213,556
Balance, December 31, 2016	\$ 46,757	\$ (1,583 )	\$ 113,448	\$ (3,262 )	\$ 155,360
Nine Months Ended September 30, 2017					
Net income	—	—	9,592	—	9,592
Other comprehensive income	—	—	—	3,651	3,651
Exercise of stock options - 2,000 shares	12	—	—	—	12
Share-based compensation expense	285	—	—	—	285
Unallocated ESOP shares committed to be released - 29,920 shares	358	323	—	—	681
Acquisition of First Century Bankshares, Inc. - 1,537,912 shares, net of issuance costs	32,968	—	—	—	32,968
Common stock issuances from reinvested dividends - 4,921 shares	116	—	—	—	116
Common stock cash dividends declared (\$0.33 per share)	—	—	(3,883 )	—	(3,883 )
Balance, September 30, 2017	\$ 80,496	\$ (1,260 )	\$ 119,157	\$ 389	\$ 198,782

See Notes to Consolidated Financial Statements

Table of Contents

6

---

## Consolidated Statements of Cash Flows (unaudited)

Dollars in thousands	Nine Months Ended	
	September 30, 2018	September 30, 2017
Cash Flows from Operating Activities		
Net income	\$ 20,622	\$ 9,592
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,609	1,364
Provision for loan losses	1,750	875
Share-based compensation expense	292	285
Deferred income tax benefit	(164)	(364)
Loans originated for sale	(11,197)	(11,305)
Proceeds from sale of loans	11,057	11,492
Gains on loans held for sale	(208)	(231)
Realized securities gains, net	(828)	(58)
Loss (gain) on disposal of assets	2	(93)
Write-downs of foreclosed properties	458	538
Amortization of securities premiums, net	2,698	3,125
Accretion related to acquisitions, net	(393)	(870)
Amortization of intangibles	1,261	974
Earnings on bank owned life insurance	(850)	(425)
Increase in accrued interest receivable	(301)	(752)
Decrease in other assets	115	1,808
Increase (decrease) in other liabilities	2,172	(221)
Net cash provided by operating activities	28,095	15,734
Cash Flows from Investing Activities		
Proceeds from maturities and calls of securities available for sale	1,050	2,610
Proceeds from sales of securities available for sale	92,048	131,345
Principal payments received on securities available for sale	19,770	24,349
Purchases of securities available for sale	(81,929)	(118,346)
Purchases of other investments	(9,922)	(13,116)
Proceeds from redemptions of other investments	9,665	13,274
Net loan originations	(42,807)	(26,099)
Purchases of premises and equipment	(4,288)	(5,672)
Proceeds from disposal of premises and equipment	12	—
Improvements to property held for sale	(1,118)	(269)
Proceeds from sales of repossessed assets & property held for sale	1,723	4,463
Cash and cash equivalents acquired in acquisition, net of \$14,989 cash consideration paid	—	39,053
Net cash (used in) provided by investing activities	(15,796)	51,592
Cash Flows from Financing Activities		
Net increase (decrease) in demand deposit, NOW and savings accounts	53,110	(9,812)
Net decrease in time deposits	(2,485)	(19,305)
Net decrease in short-term borrowings	(12,096)	(28,782)
Repayment of long-term borrowings	(45,012)	(915)
Net proceeds from issuance of common stock	179	(43)
Exercise of stock options	29	12
Dividends paid on common stock	(4,821)	(3,883)
Net cash used in financing activities	(11,096)	(62,728)

Increase in cash and cash equivalents	1,203	4,598
Cash and cash equivalents:		
Beginning	52,631	46,616
Ending	\$53,834	\$ 51,214

(Continued)

See Notes to Consolidated Financial Statements

Table of Contents

7

---

Consolidated Statements of Cash Flows (unaudited) - continued

Dollars in thousands	Nine Months Ended	
	September 30,	September 30,
	2018	2017
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	\$ 18,199	\$ 13,055
Income taxes	\$ 5,674	\$ 3,557
Supplemental Disclosures of Noncash Investing and Financing Activities		
Real property and other assets acquired in settlement of loans	\$ 1,542	\$ 289

See Notes to Consolidated Financial Statements

Table of Contents

8

---



## NOTE 1. BASIS OF PRESENTATION

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

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

The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2017 audited financial statements and Annual Report on Form 10-K.

## NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

### Recently Adopted

We adopted ASU 2014-09, Revenue from Contracts with Customers: Topic 606, and its related amendments on its required effective date of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. We concluded that ASU 2014-09 did not materially change the method in which we currently recognize revenue for these revenue streams. We also completed our evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on our evaluation, we determined that any classification changes were immaterial to both revenue and expense.

ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements. In accordance with (iv) above, we measure the fair value of our loan portfolio using exit price notion (see Note 3. Fair Value Measurements).

### Pending Adoption

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach.

Table of Contents

9

---

The FASB made subsequent amendments to Topic 842 in July 2018 through ASU 2018-10 Codification Improvements to Topic 842, Leases, and ASU 2018-11 Leases (Topic 842): Targeted Improvements. Among these amendments is the provision in ASU 2018-11 that provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases). While we are currently assessing the impact of the adoption of this pronouncement, we expect the primary impact to our consolidated financial position upon adoption will be the recognition, on a discounted basis, of our minimum commitments under non-cancellable operating leases on our consolidated balance sheets resulting in the recording of right of use assets and lease obligations. Our current minimum commitments under long-term operating leases are disclosed in Note 12, Commitments and Contingencies.

During June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments. The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. We will adopt the guidance by the first quarter of 2020 with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. In this regard, we have a cross-functional implementation team comprised of personnel from risk management, operations and information technology, loan administration and finance and engaged a third-party to assist us. The team has developed a project plan, identified key decision points and prepared a readiness assessment and gap analysis relative to required data which serves to direct our areas of focus. In addition, we have collected applicable historical data and made preliminary decisions regarding methodology and loan pool structures. We will continue to evaluate the impact the new standard will have on our consolidated financial statements as the final impact will be dependent, among other items, upon the loan portfolio composition and credit quality at the adoption date, as well as economic conditions, financial models used and forecasts at that time. In March of 2017, the FASB issued ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. This guidance shortens the amortization period for premiums on certain callable debt securities to the earliest call date (with an explicit, noncontingent call feature that is callable at a fixed price and on a preset date), rather than contractual maturity date as currently required under GAAP. The ASU does not impact instruments without preset call dates such as mortgage-backed securities. For instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the ASU. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. The adoption of the new pronouncement will not have a significant impact on our consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, Targeted Improvements to Accounting for Hedging Activities which will make more financial and nonfinancial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess effectiveness. It is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting, and increase transparency as to the scope and results of hedging programs. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. We do not expect it to have a material impact on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement. The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. We do not expect the adoption of ASU 2018-13 to have a material impact on our consolidated financial statements.

## NOTE 3. FAIR VALUE MEASUREMENTS

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

Dollars in thousands	Balance at September 30, 2018	Fair Value Measurements Using:	
		Level 1 Level 2	Level 3
Securities available for sale			
U.S. Government sponsored agencies	\$ 27,279	\$—\$27,279	\$ —
Mortgage backed securities:			
Government sponsored agencies	72,942	—72,942	—
Nongovernment sponsored entities	685	—685	—
State and political subdivisions	18,774	—18,774	—
Corporate debt securities	11,687	—11,687	—
Asset-backed securities	21,792	—21,792	—
Other equity securities	137	—137	—
Tax-exempt state and political subdivisions	134,744	—134,744	—
Total securities available for sale	\$ 288,040	\$—\$288,040	\$ —

Derivative financial assets			
Interest rate swaps	\$ 1,063	\$—\$1,063	\$ —

Derivative financial liabilities			
Interest rate swaps	\$ 284	\$—\$284	\$ —

Dollars in thousands	Balance at December 31, 2017	Fair Value Measurements Using:	
		Level 1 Level 2	Level 3
Securities available for sale			
U.S. Government sponsored agencies	\$ 31,613	\$—\$31,613	\$ —
Mortgage backed securities:			
Government sponsored agencies	121,321	—121,321	—
Nongovernment sponsored entities	2,077	—2,077	—
State and political subdivisions	17,677	—17,677	—
Corporate debt securities	16,245	—16,245	—
Other equity securities	137	—137	—
Tax-exempt state and political subdivisions	139,653	—139,653	—
Total securities available for sale	\$ 328,723	\$—\$328,723	\$ —

Derivative financial assets			
Interest rate swaps	\$ 312	\$—\$312	\$ —

Derivative financial liabilities			
Interest rate swaps	\$ 2,057	\$—\$2,057	\$ —

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

Table of Contents

11

---

	Balance at	Fair Value Measurements Using:	
Dollars in thousands	September 30, 2018	Level 1	Level 2
Residential mortgage loans held for sale	\$ 348	\$—	\$ 348
Collateral-dependent impaired loans			
Commercial	\$ 57	\$—	\$ 57
Commercial real estate	437	\$—	437
Construction and development	297	\$—	297
Residential real estate	721	\$—	721
Total collateral-dependent impaired loans	\$ 1,512	\$—	\$ 1,512
Property held for sale			
Commercial real estate	\$ 1,677	\$—	\$ 1,677
Construction and development	16,526	\$—	16,526
Residential real estate	403	\$—	403
Total property held for sale	\$ 18,606	\$—	\$ 18,606

  

	Balance at	Fair Value Measurements Using:	
Dollars in thousands	December 31, 2017	Level 1	Level 2
Residential mortgage loans held for sale	\$ —	\$—	\$ —
Collateral-dependent impaired loans			
Commercial real estate	\$ 518	\$—	\$ 518
Construction and development	940	\$—	940
Residential real estate	203	\$—	203
Total collateral-dependent impaired loans	\$ 1,661	\$—	\$ 1,661
Property held for sale			
Commercial real estate	\$ 1,493	\$—	\$ 1,493
Construction and development	16,177	\$—	16,177
Residential real estate	322	\$—	322
Total property held for sale	\$ 17,992	\$—	\$ 17,992

# [Table of Contents](#)

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

Dollars in thousands	September 30, 2018		Fair Value Measurements Using:	
	Carrying Value	Estimated Fair Value	Level 1 Level 2	Level 3
Financial assets				
Cash and cash equivalents	\$53,834	\$53,834	\$53,834	\$—
Securities available for sale	288,040	288,040	—288,040	—
Other investments	14,232	14,232	—14,232	—
Loans held for sale, net	348	348	—348	—
Loans, net	1,632,747	1,610,856	—1,463	1,609,393
Accrued interest receivable	8,630	8,630	—8,630	—
Derivative financial assets	1,063	1,063	—1,063	—
	\$1,998,894	\$1,977,003	\$367,610	\$1,609,393
Financial liabilities				
Deposits	\$1,651,064	\$1,648,845	\$1,648,845	\$—
Short-term borrowings	238,403	238,403	—238,403	—
Long-term borrowings	739	834	—834	—
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	—19,589	—
Accrued interest payable	1,068	1,068	—1,068	—
Derivative financial liabilities	284	284	—284	—
	\$1,911,147	\$1,909,023	\$1,909,023	\$—
Dollars in thousands	December 31, 2017		Fair Value Measurements Using:	
	Carrying Value	Estimated Fair Value	Level 1 Level 2	Level 3
Financial assets				
Cash and cash equivalents	\$52,631	\$52,631	\$52,631	\$—
Securities available for sale	328,723	328,723	—328,723	—
Other investments	14,934	14,934	—14,934	—
Loans held for sale, net	—	—	—	—
Loans, net	1,593,744	1,592,821	—1,661	1,591,160
Accrued interest receivable	8,329	8,329	—8,329	—
Derivative financial assets	312	312	—312	—
	\$1,998,673	\$1,997,750	\$406,590	\$1,591,160
Financial liabilities				
Deposits	\$1,600,601	\$1,620,033	\$1,620,033	\$—
Short-term borrowings	250,499	250,499	—250,499	—
Long-term borrowings	45,751	46,530	—46,530	—
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	—19,589	—
Accrued interest payable	987	987	—987	—
Derivative financial liabilities	2,057	2,057	—2,057	—
	\$1,919,484	\$1,939,695	\$1,939,695	\$—

[Table of Contents](#)





## NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

Dollars in thousands, except per share amounts	For the Three Months Ended September 30, 2018			2017		
	Income (Numerator)	Common Shares (Denominator)	Per Share	Income (Numerator)	Common Shares (Denominator)	Per Share
Net income	\$6,899			\$5,930		
Basic earnings per share	\$6,899	12,374,350	\$0.56	\$5,930	12,299,987	\$0.48
Effect of dilutive securities:						
Stock options		7,349			10,911	
Stock appreciation rights (SARs)		57,352			8,061	
Diluted earnings per share	\$6,899	12,439,051	\$0.55	\$5,930	12,318,959	\$0.48
Dollars in thousands, except per share amounts	For the Nine Months Ended September 30, 2018			2017		
	Income (Numerator)	Common Shares (Denominator)	Per Share	Income (Numerator)	Common Shares (Denominator)	Per Share
Net income	\$20,622			\$9,592		
Basic earnings per share	\$20,622	12,366,612	\$1.67	\$9,592	11,781,342	\$0.81
Effect of dilutive securities:						
Stock options		7,561			11,336	
Stock appreciation rights (SARs)		56,054			14,324	
Diluted earnings per share	\$20,622	12,430,227	\$1.66	\$9,592	11,807,002	\$0.81

Stock option and stock appreciation right (SAR) grants are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options for the three and nine months ended September 30, 2018 were 15,600 shares and for the three and nine months ended September 30, 2017 were 23,400 shares. Our anti-dilutive SARs for the three and nine months ended September 30, 2018 and September 30, 2017 were 87,615.

[Table of Contents](#)

## NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at September 30, 2018 and December 31, 2017 are summarized as follows:

Dollars in thousands	September 30, 2018			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	\$27,504	\$163	\$388	\$27,279
Residential mortgage-backed securities:				
Government-sponsored agencies	73,931	557	1,546	72,942
Nongovernment-sponsored entities	682	4	1	685
State and political subdivisions				
General obligations	6,084	—	266	5,818
Other revenues	13,462	—	506	12,956
Corporate debt securities	11,914	—	227	11,687
Asset-backed securities	21,861	10	79	21,792
Total taxable debt securities	155,438	734	3,013	153,159
Tax-exempt debt securities				
State and political subdivisions				
General obligations	72,299	239	1,200	71,338
Water and sewer revenues	18,921	75	214	18,782
Lease revenues	13,305	32	57	13,280
Electric revenues	4,170	15	63	4,122
Other revenues	27,828	27	633	27,222
Total tax-exempt debt securities	136,523	388	2,167	134,744
Equity securities	137	—	—	137
Total securities available for sale	\$292,098	\$1,122	\$5,180	\$288,040

Dollars in thousands	December 31, 2017			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities				
U.S. Government and agencies and corporations	\$31,260	\$498	\$145	\$31,613
Residential mortgage-backed securities:				
Government-sponsored agencies	120,948	1,276	903	121,321
Nongovernment-sponsored entities	2,045	39	7	2,077
State and political subdivisions				
General obligations	6,090	—	55	6,035
Other revenues	11,657	47	62	11,642
Corporate debt securities	16,375	—	130	16,245
Total taxable debt securities	188,375	1,860	1,302	188,933
Tax-exempt debt securities				
State and political subdivisions				
General obligations	65,560	1,530	198	66,892
Water and sewer revenues	23,108	566	3	23,671

Lease revenues	13,024	451	2	13,473
Electric revenues	6,205	128	—	6,333
Sales tax revenues	4,126	140	—	4,266
University revenues	5,272	38	9	5,301
Other revenues	19,101	616	—	19,717
Total tax-exempt debt securities	136,396	3,469	212	139,653
Equity securities	137	—	—	137
Total securities available for sale	\$ 324,908	\$ 5,329	\$ 1,514	\$ 328,723

Table of Contents

15

---

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

Dollars in thousands	September 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Texas	\$21,796	\$65	\$202	\$21,659
California	18,021	39	438	17,622
Michigan	14,631	40	311	14,360
West Virginia	13,258	50	179	13,129
Illinois	11,014	72	234	10,852

Management performs pre-purchase and ongoing analysis to confirm that all investment securities meet applicable credit quality standards.

The maturities, amortized cost and estimated fair values of securities at September 30, 2018, are summarized as follows:

Dollars in thousands	Amortized Cost	Estimated Fair Value
Due in one year or less	\$26,929	\$26,769
Due from one to five years	49,907	49,401
Due from five to ten years	47,782	46,343
Due after ten years	167,343	165,390
Equity securities	137	137
	\$292,098	\$288,040

The proceeds from sales, calls and maturities of securities available for sale, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the nine months ended September 30, 2018 and 2017 are as follows:

Dollars in thousands	Proceeds from			Gross realized	
	Sales	Calls and Maturities	Principal Payments	Gains	Losses
For the Nine Months Ended September 30, 2018					
Securities available for sale	\$92,048	\$1,050	\$19,770	\$1,754	\$926
2017					
Securities available for sale	\$131,345	\$2,610	\$24,349	\$416	\$358

We held 153 available for sale securities having an unrealized loss at September 30, 2018. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no other-than-temporary impairment charge to earnings is warranted at this time.

Table of Contents

16

---

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

Provided below is a summary of securities available for sale which were in an unrealized loss position at September 30, 2018 and December 31, 2017.

Dollars in thousands	September 30, 2018					
	Less than 12 months Estimated Fair Value	Unrealized Loss	12 months or more Estimated Fair Value	Unrealized Loss	Total Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U.S. Government agencies and corporations	\$ 17,532	\$ (309 )	\$ 3,166	\$ (79 )	\$ 20,698	\$ (388 )
Residential mortgage-backed securities:						
Government-sponsored agencies	20,636	(586 )	18,981	(960 )	39,617	(1,546 )
Nongovernment-sponsored entities	—	—	501	(1 )	501	(1 )
State and political subdivisions:						
General obligations	4,615	(227 )	1,203	(39 )	5,818	(266 )
Other revenues	8,339	(284 )	4,617	(222 )	12,956	(506 )
Corporate debt securities	984	(16 )	4,574	(211 )	5,558	(227 )
Asset-backed securities	16,308	(79 )	—	—	16,308	(79 )
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	42,996	(971 )	5,002	(229 )	47,998	(1,200 )
Water and sewer revenues	10,916	(214 )	—	—	10,916	(214 )
Lease revenues	7,736	(57 )	—	—	7,736	(57 )
Electric revenues	2,407	(63 )	—	—	2,407	(63 )
Other revenues	20,865	(560 )	1,667	(73 )	22,532	(633 )
Total temporarily impaired securities	153,334	(3,366 )	39,711	(1,814 )	193,045	(5,180 )
Total	\$ 153,334	\$ (3,366 )	\$ 39,711	\$ (1,814 )	\$ 193,045	\$ (5,180 )

Dollars in thousands	December 31, 2017					
	Less than 12 months Estimated Fair Value	Unrealized Loss	12 months or more Estimated Fair Value	Unrealized Loss	Total Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U.S. Government agencies and corporations	\$ 10,864	\$ (91 )	\$ 2,394	\$ (54 )	\$ 13,258	\$ (145 )
Residential mortgage-backed securities:						
Government-sponsored agencies	32,156	(269 )	22,584	(634 )	54,740	(903 )
Nongovernment-sponsored entities	5	—	810	(7 )	815	(7 )
State and political subdivisions:						
General obligations	6,035	(55 )	—	—	6,035	(55 )
Other revenues	7,532	(62 )	—	—	7,532	(62 )
Corporate debt securities	3,008	(39 )	1,659	(91 )	4,667	(130 )
Tax-exempt debt securities						
State and political subdivisions:						
General obligations	2,999	(20 )	9,937	(178 )	12,936	(198 )
Water and sewer revenues	282	(3 )	—	—	282	(3 )
Lease revenues	569	(2 )	—	—	569	(2 )

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

University revenues	1,749	(9	)	—	—	1,749	(9	)	
Total temporarily impaired securities	65,199	(550	)	37,384	(964	)	102,583	(1,514	)
Total	\$65,199	\$ (550	)	\$37,384	\$ (964	)	\$102,583	\$ (1,514	)

Table of Contents

17

---



## NOTE 6. LOANS

Loans are summarized as follows:

Dollars in thousands	September 30, 2018	December 31, 2017
Commercial	\$ 167,972	\$ 189,981
Commercial real estate		
Owner-occupied	272,475	250,202
Non-owner occupied	530,568	484,902
Construction and development		
Land and land development	71,819	67,219
Construction	25,703	33,412
Residential real estate		
Non-jumbo	340,783	354,101
Jumbo	72,327	62,267
Home equity	82,018	84,028
Mortgage warehouse lines	35,910	30,757
Consumer	33,664	36,202
Other	12,452	13,238
Total loans, net of unearned fees	1,645,691	1,606,309
Less allowance for loan losses	12,944	12,565
Loans, net	\$ 1,632,747	\$ 1,593,744

The outstanding balance and the recorded investment of acquired loans included in the consolidated balance sheet at September 30, 2018 and December 31, 2017 are as follows:

Dollars in thousands	Acquired Loans September 30, 2018			December 31, 2017		
	Purchased Credit Impaired	Purchased Performing	Total	Purchased Credit Impaired	Purchased Performing	Total
Outstanding balance	\$5,228	\$ 159,567	\$ 164,795	\$5,923	\$ 220,131	\$ 226,054
Recorded investment						
Commercial	\$—	\$ 7,969	\$7,969	\$9	\$ 25,125	\$25,134
Commercial real estate						
Owner-occupied	682	18,620	19,302	689	21,893	22,582
Non-owner occupied	1,314	28,492	29,806	1,837	33,293	35,130
Construction and development						
Land and land development	—	6,066	6,066	—	7,512	7,512
Construction	—	—	—	—	2,760	2,760
Residential real estate						
Non-jumbo	1,407	84,482	85,889	1,485	109,570	111,055
Jumbo	976	2,598	3,574	999	3,400	4,399
Home equity	—	2,839	2,839	—	3,311	3,311
Consumer	—	6,793	6,793	—	11,229	11,229
Other	—	129	129	—	211	211
Total recorded investment	\$4,379	\$ 157,988	\$ 162,367	\$5,019	\$ 218,304	\$ 223,323

Table of Contents

18

---

The following table presents a summary of the change in the accretable yield of the purchased credit impaired ("PCI") loan portfolio for the three and nine months ended September 30, 2018 and 2017:

	For the Three Months Ended September 30, 2018		For the Nine Months Ended September 30, 2017	
Dollars in thousands	2018	2017	2018	2017
Accretable yield	\$676	\$851	\$745	\$290
Accretion	(12 )	(49 )	(81 )	(135 )
Additions for First Century Bankshares, Inc. acquisition	—	—	—	661
Reclassification of nonaccretable difference due to improvement in expected cash flows	—	—	—	—
Other changes, net	—	1	—	(13 )
Accretable yield, September 30	\$664	\$803	\$664	\$803

The following table presents the contractual aging of the recorded investment in past due loans by class as of September 30, 2018 and December 31, 2017.

	At September 30, 2018					
	Past Due					
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	> 90 days and Accruing
Commercial	\$550	\$266	\$391	\$1,207	\$166,765	\$ —
Commercial real estate						
Owner-occupied	612	—	2,326	2,938	269,537	1,991
Non-owner occupied	385	67	2,227	2,679	527,889	—
Construction and development						
Land and land development	120	277	3,196	3,593	68,226	—
Construction	—	—	—	—	25,703	—
Residential mortgage						
Non-jumbo	4,854	1,397	4,685	10,936	329,847	68
Jumbo	—	—	—	—	72,327	—
Home equity	95	—	92	187	81,831	—
Mortgage warehouse lines	—	—	—	—	35,910	—
Consumer	259	102	113	474	33,190	156
Other	—	—	—	—	12,452	—
Total	\$6,875	\$2,109	\$13,030	\$22,014	\$1,623,677	\$ 2,215

[Table of Contents](#)

Dollars in thousands	At December 31, 2017			Total	Current	> 90 days and Accruing
	Past Due 30-59 days	60-89 days	> 90 days			
Commercial	\$488	\$98	\$229	\$815	\$189,166	\$ —
Commercial real estate						
Owner-occupied	626	162	507	1,295	248,907	—
Non-owner occupied	369	150	2,065	2,584	482,318	237
Construction and development						
Land and land development	1,132	—	3,563	4,695	62,524	—
Construction	—	—	—	—	33,412	—
Residential mortgage						
Non-jumbo	4,220	2,379	4,451	11,050	343,051	—
Jumbo	—	—	—	—	62,267	—
Home equity	1,978	—	530	2,508	81,520	—
Mortgage warehouse lines	—	—	—	—	30,757	—
Consumer	417	196	167	780	35,422	37
Other	—	—	—	—	13,238	—
Total	\$9,230	\$2,985	\$11,512	\$23,727	\$1,582,582	\$ 274

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at September 30, 2018 and December 31, 2017.

Dollars in thousands	September 30, 2018	December 31, 2017
Commercial	\$ 801	\$ 696
Commercial real estate		
Owner-occupied	551	726
Non-owner occupied	2,548	2,201
Construction and development		
Land & land development	3,200	3,569
Construction	—	—
Residential mortgage		
Non-jumbo	7,371	6,944
Jumbo	—	—
Home equity	204	712
Mortgage warehouse lines	—	—
Consumer	80	201
Total	\$ 14,755	\$ 15,049

Impaired loans: Impaired loans include the following:

Loans which we risk-rate (loan relationships having aggregate balances in excess of \$2.5 million, or loans exceeding \$500,000 and exhibiting credit weakness) through our normal loan review procedures and which, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement. Risk-rated loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired.

Loans that have been modified in a troubled debt restructuring.

Table of Contents

20

---

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

Table of Contents

21

---

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

The following tables present loans individually evaluated for impairment at September 30, 2018 and December 31, 2017.

Dollars in thousands	September 30, 2018			Average Impaired Balance	Interest Income Recognized while impaired
	Recorded Investment	Unpaid Principal Balance	Related Allowance		
Without a related allowance					
Commercial	\$4,400	\$4,400	\$ —	\$ 438	\$ 12
Commercial real estate					
Owner-occupied	9,007	9,012	—	7,630	308
Non-owner occupied	9,106	9,108	—	9,175	487
Construction and development					
Land & land development	4,128	4,128	—	4,291	63
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	4,448	4,458	—	3,572	161
Jumbo	3,480	3,479	—	3,504	167
Home equity	523	523	—	523	30
Mortgage warehouse lines	—	—	—	—	—
Consumer	11	11	—	13	1
Total without a related allowance	\$35,103	\$35,119	\$ —	\$29,146	\$ 1,229
With a related allowance					
Commercial	\$83	\$83	\$ 26	\$ 72	\$ —
Commercial real estate					
Owner-occupied	2,369	2,369	271	2,392	117
Non-owner occupied	708	714	88	749	17
Construction and development					
Land & land development	1,756	1,756	772	1,773	98
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	2,932	2,932	588	2,425	97
Jumbo	826	826	107	830	48
Home equity	—	—	—	—	—
Mortgage warehouse lines	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	\$8,674	\$8,680	\$ 1,852	\$8,241	\$ 377
Total					
Commercial	\$31,557	\$31,570	\$ 1,157	\$26,520	\$ 1,102
Residential real estate	12,209	12,218	695	10,854	503
Consumer	11	11	—	13	1
Total	\$43,777	\$43,799	\$ 1,852	\$37,387	\$ 1,606

The table above does not include PCI loans.

Table of Contents

22

---



Dollars in thousands	December 31, 2017				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$243	\$243	\$ —	\$259	\$ 13
Commercial real estate					
Owner-occupied	7,109	7,111	—	5,149	265
Non-owner occupied	9,105	9,106	—	9,736	684
Construction and development					
Land & land development	5,018	5,018	—	4,743	329
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	4,190	4,199	—	4,214	240
Jumbo	3,555	3,554	—	3,592	228
Home equity	523	523	—	523	35
Mortgage warehouse lines	—	—	—	—	—
Consumer	17	17	—	28	3
Total without a related allowance	\$29,760	\$29,771	\$ —	\$28,244	\$ 1,797
With a related allowance					
Commercial	\$252	\$252	\$ 252	\$262	\$ —
Commercial real estate					
Owner-occupied	2,436	2,436	125	2,451	161
Non-owner occupied	1,338	1,344	517	676	43
Construction and development					
Land & land development	1,464	1,464	524	1,477	74
Construction	—	—	—	—	—
Residential real estate					
Non-jumbo	1,717	1,718	158	1,691	100
Jumbo	838	839	14	845	57
Home equity	—	—	—	—	—
Mortgage warehouse lines	—	—	—	—	—
Consumer	—	—	—	—	—
Total with a related allowance	\$8,045	\$8,053	\$ 1,590	\$7,402	\$ 435
Total					
Commercial	\$26,965	\$26,974	\$ 1,418	\$24,753	\$ 1,569
Residential real estate	10,823	10,833	172	10,865	660
Consumer	17	17	—	28	3
Total	\$37,805	\$37,824	\$ 1,590	\$35,646	\$ 2,232

The table above does not include PCI loans.

Table of Contents

23

---

Included in impaired loans are TDRs of \$27.6 million, of which \$27.4 million were current with respect to restructured contractual payments at September 30, 2018, and \$28.4 million, all of which were current with respect to restructured contractual payments at December 31, 2017. There were no commitments to lend additional funds under these restructurings at either balance sheet date.

The following tables present by class the TDRs that were restructured during the three and nine months ended September 30, 2018 and September 30, 2017. Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes.

Dollars in thousands	For the Three Months Ended September 30, 2018		For the Three Months Ended September 30, 2017	
	Number of Recorded Modifications	Pre-modification Post-modification Recorded Investment	Number of Recorded Modifications	Pre-modification Post-modification Recorded Investment
Commercial real estate				
Owner-occupied	—	\$ —	1	\$ 2,302
Non-owner occupied	—	—	1	148
Construction and development				
Land & land development	—	—	1	438
Residential real estate				
Non-jumbo	2	94	—	—
Total	2	\$ 94	3	\$ 2,888

Dollars in thousands	For the Nine Months Ended September 30, 2018		For the Nine Months Ended September 30, 2017	
	Number of Recorded Modifications	Pre-modification Post-modification Recorded Investment	Number of Recorded Modifications	Pre-modification Post-modification Recorded Investment
Commercial	2	\$ 157	—	\$ —
Commercial real estate				
Owner-occupied	—	\$ —	1	2,302
Non-owner occupied	—	—	1	148
Construction and development				
Land & land development	—	—	1	438
Residential real estate				
Non-jumbo	8	899	5	1,086
Total	10	\$ 1,056	8	\$ 3,974

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

Dollars in thousands	For the Three Months Ended September 30, 2018	For the Three Months Ended September 30, 2017
	Number of Recorded Investment	Number of Recorded Investment

	Default Date	Default Date	Default Date	Default Date
Construction and development				
Land & land development	— \$	—1	\$ 437	
Residential real estate				
Non-jumbo	— —	4	1,104	
Total	— \$	—5	\$ 1,541	

Table of Contents

24

---

	For the Nine Months Ended September 30, 2018	For the Nine Months Ended September 30, 2017
Dollars in thousands	Recorded Number of Investment at Default Date	Recorded Number of Investment at Default Date
Commercial	2 \$ 157	— \$ —
Commercial real estate		
Non-owner occupied	1 341	— —
Construction and development		
Land & land development	— —	1 437
Residential real estate		
Non-jumbo	3 628	4 1,204
Total	6 \$ 1,126	5 \$ 1,641

The following tables detail the activity regarding TDRs by loan type, net of fees, for the three and nine months ended September 30, 2018, and the related allowance on TDRs.

For the Three Months Ended September 30, 2018

	Construction & Land Development	Commercial Real Estate	Residential Real Estate								
Dollars in thousands	Land & Develop- ment	Const- tion	Owner Occupied	Non- Owner Occupied	Non- jumbo	Jumbo	Home Equity	Mortgage Warehouse Lines	Con- sumer	Other	Total
Troubled debt restructurings											
Balance July 1, 2018	\$ 2,948	\$ —	\$ 293	\$ 9,433	\$ 5,306	\$ 4,972	\$ 4,339	\$ 523	\$ —	\$ 13	\$ —
Additions	—	—	—	—	—	94	—	—	—	—	94
Charge-offs	—	—	—	—	—	—	—	—	—	—	—
Net (paydowns) advances	(203 )	—	(13 )	(48 )	(38 )	(31 )	(33 )	—	—	(2 )	(368 )
Transfer into foreclosed properties	—	—	—	—	—	—	—	—	—	—	—
Refinance out of TDR status	—	—	—	—	—	—	—	—	—	—	—
Balance, September 30, 2018	\$ 2,745	\$ —	\$ 280	\$ 9,385	\$ 5,268	\$ 5,035	\$ 4,306	\$ 523	\$ —	\$ 11	\$ —
Allowance related to troubled debt restructurings	\$ 772	\$ —	\$ —	\$ 271	\$ 12	\$ 210	\$ 107	\$ —	\$ —	\$ —	\$ —

For the Nine Months Ended September 30, 2018

	Construction & Land Development	Commercial Real Estate	Residential Real Estate								
Dollars in thousands	Land & Develop- ment	Const- tion	Owner Occupied	Non- Owner Occupied	Non- jumbo	Jumbo	Home Equity	Mortgage Warehouse Lines	Con- sumer	Other	Total

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

	Land Develop- ment	tion cial	Occupied	Owner Occupied	jumbo		Equity	Mortgage	Consumer	Warehouse	Lines
Troubled debt restructurings											
Balance January 1, 2018	\$ 3,043	\$ — \$ 412	\$ 9,545	\$ 5,234	\$ 5,195	\$ 4,393	\$ 523	\$ — \$ 18	\$ — \$ 28,363		
Additions	—	— 157	—	—	899	—	—	—	—	— 1,056	
Charge-offs	—	— —	—	—	(55 )	—	—	—	—	— (55 )	
Net (paydowns) advances	(298 )	— (289 )	(160 )	34	(1,004 )	(87 )	—	—	(7 )	— (1,811 )	
Transfer into foreclosed properties	—	— —	—	—	—	—	—	—	—	— —	
Refinance out of TDR status	—	— —	—	—	—	—	—	—	—	— —	
Balance, September 30, 2018	\$ 2,745	\$ — \$ 280	\$ 9,385	\$ 5,268	\$ 5,035	\$ 4,306	\$ 523	\$ — \$ 11	\$ — \$ 27,553		
Allowance related to troubled debt restructurings	\$ 772	\$ — \$ —	\$ 271	\$ 12	\$ 210	\$ 107	\$ —	\$ — \$ —	\$ — \$ 1,372		

[Table of Contents](#)

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

#### Loan Risk Profile by Internal Risk Rating

	Construction and Development						Commercial Real Estate					
	Land and Land Development		Construction		Commercial		Owner Occupied		Non-Owner Occupied		Mortgage Warehouse Lines	
Dollars in thousands	9/30/2018	12/31/2017	9/30/2018	12/31/2017	9/30/2018	12/31/2017	9/30/2018	12/31/2017	9/30/2018	12/31/2017	9/30/2018	12/31/2017
Pass	\$66,657	\$60,850	\$25,560	\$33,412	\$161,682	\$186,941	\$264,991	\$242,702	\$522,182	\$474,522	\$35,910	\$30,000
OLEM (Special Mention)	567	1,397	143	—	1,520	2,267	2,380	3,534	1,549	2,221	—	—
Substandard	4,595	4,972	—	—	4,770	773	5,104	3,966	6,837	8,159	—	—
Doubtful	—	—	—	—	—	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	—	—	—	—	—	—
Total	\$71,819	\$67,219	\$25,703	\$33,412	\$167,972	\$189,981	\$272,475	\$250,202	\$530,568	\$484,902	\$35,910	\$30,000

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

Dollars in thousands	Performing		Nonperforming	
	9/30/2018	12/31/2017	9/30/2018	12/31/2017
Residential real estate				
Non-jumbo	\$333,227	\$347,183	\$7,556	\$6,918
Jumbo	72,327	62,267	—	—
Home Equity	81,814	83,316	204	712
Consumer	33,545	35,932	119	270
Other	12,452	13,238	—	—
Total	\$533,365	\$541,936	\$7,879	\$7,900

[Table of Contents](#)

## NOTE 7. ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses for the nine month period ended September 30, 2018 and for the year ended December 31, 2017 is as follows:

	September 30, 2018	December 31, 2017
Dollars in thousands		
Balance, beginning of year	\$ 12,565	\$ 11,674
Charge-offs:		
Commercial	248	23
Commercial real estate		
Owner occupied	38	5
Non-owner occupied	500	65
Construction and development		
Land and land development	222	3
Construction	—	33
Residential real estate		
Non-jumbo	460	359
Jumbo	—	2
Home equity	25	158
Mortgage warehouse lines	—	—
Consumer	195	389
Other	211	251
Total	1,899	1,288
Recoveries:		
Commercial	12	124
Commercial real estate		
Owner occupied	19	89
Non-owner occupied	—	91
Construction and development		
Land and land development	217	278
Construction	—	—
Residential real estate		
Non-jumbo	75	134
Jumbo	—	—
Home equity	7	30
Mortgage warehouse lines	—	—
Consumer	107	82
Other	91	101
Total	528	929
Net charge-offs	1,371	359
Provision for loan losses	1,750	1,250
Balance, end of period	\$ 12,944	\$ 12,565

Table of Contents



The following table presents the activity in the allowance for loan losses, balance in the allowance for loan losses and recorded investment in loans by portfolio segment and based on impairment during the first nine months of 2018 and for the year ended 2017:

	For the Nine Months Ended September 30, 2018					At September 30, 2018				At September 30, 2017			
	Allowance for loan losses					Allowance related to:				Loans			
	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Loans individually evaluated for impairment	Loans collectively evaluated for impairment	Loans acquired with deteriorated credit quality (PCI)	Total	Loans individually evaluated for impairment	Loans collectively evaluated for impairment	Loans acquired with deteriorated credit quality (PCI)	Total
Commercial	\$1,303	\$(248)	\$12	\$(68)	\$999	\$26	\$973	\$—	\$999	\$4,483	\$163,489	\$—	\$167,972
Commercial real estate													
Owner occupied	2,424	(38)	19	321	2,726	271	2,455	—	2,726	11,376	260,417	682	272,475
Non-owner occupied	4,950	(500)	—	779	5,229	88	5,138	3	5,229	9,814	519,440	1,314	530,568
Construction and development													
Land and land development	641	(222)	217	161	797	772	25	—	797	5,884	65,935	—	71,819
Construction	153	—	—	(40)	113	—	113	—	113	—	25,703	—	25,703
Residential real estate													
Non-jumbo	1,911	(460)	75	691	2,217	588	1,620	9	2,217	7,380	331,996	1,407	340,783
Jumbo	72	—	—	311	383	107	276	—	383	4,306	67,045	976	72,327
Home equity	638	(25)	7	(469)	151	—	151	—	151	523	81,495	—	82,018
Mortgage warehouse lines	—	—	—	—	—	—	—	—	—	—	35,910	—	35,910
Consumer	210	(195)	107	69	191	—	191	—	191	11	33,653	—	33,664
Other	263	(211)	91	(5)	138	—	138	—	138	—	12,452	—	12,452
Total	\$12,565	\$(1,899)	\$528	\$1,750	\$12,944	\$1,852	\$11,080	\$12	\$12,944	\$43,777	\$1,597,535	\$4,379	\$1,645,691
	For the Year Ended December 31, 2017					At December 31, 2017				At December 31, 2017			
	Allowance for loan losses					Allowance related to:				Loans			
	Beginning Balance	Charge-offs	Recoveries	Provision	Ending Balance	Loans individually evaluated for impairment	Loans collectively evaluated for impairment	Loans acquired with deteriorated credit quality (PCI)	Total	Loans individually evaluated for impairment	Loans collectively evaluated for impairment	Loans acquired with deteriorated credit quality (PCI)	Total

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

Commercial real estate	\$934	\$(23)	)\$124	\$268	\$1,303	\$252	\$1,051	\$—\$1,303	\$495	\$189,477	\$9	\$189,981
Owner occupied	2,109	(5	)89	231	2,424	125	2,299	—2,424	9,545	239,968	689	250,202
Non-owner occupied	3,438	(65	)91	1,486	4,950	517	4,432	1 4,950	10,443	472,622	1,837	484,902
Construction and development												
Land and land development	2,263	(3	)278	(1,897	)641	524	117	—641	6,482	60,737	—	67,219
Construction	24	(33	)—	162	153	—	153	—153	—	33,412	—	33,412
Residential real estate												
Non-jumbo	2,174	(359	)134	(38	)1,911	158	1,747	6 1,911	5,907	346,709	1,485	354,101
Jumbo	95	(2	)—	(21	)72	14	58	—72	4,393	56,875	999	62,267
Home equity	413	(158	)30	353	638	—	638	—638	523	83,505	—	84,028
Mortgage warehouse lines	—	—	—	—	—	—	—	—	—	30,757	—	30,757
Consumer	121	(389	)82	396	210	—	210	—210	17	36,185	—	36,202
Other	103	(251	)101	310	263	—	263	—263	—	13,238	—	13,238
Total	\$11,674	\$(1,288)	)\$929	\$1,250	\$12,565	\$1,590	\$10,968	\$7\$12,565	\$37,805	\$1,563,485	\$5,019	\$1,606,309

NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

In accordance with ASU No. 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, during third quarter 2018, we performed the qualitative assessment of the goodwill of our community banking and insurance services reporting units and determined that the fair values of the reporting units were more likely than not greater than their carrying values. In performing the qualitative assessments, we considered certain events and circumstances specific to each

Table of Contents

28

reporting unit, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair values of our community banking or insurance services reporting units are less than their carrying values. No indicators of impairment for either reporting unit were noted as of September 30, 2018.

The following tables present our goodwill by reporting unit at September 30, 2018 and other intangible assets by reporting unit at September 30, 2018 and December 31, 2017.

Dollars in thousands	Goodwill Activity					
	Community Banking	Insurance Services	Total	Community Banking	Insurance Services	Total
Balance, January 1, 2018	\$10,562	\$ 4,710	\$15,272			
Reclassifications to goodwill	—	—	—			
Acquired goodwill, net	—	—	—			
Balance, September 30, 2018	\$10,562	\$ 4,710	\$15,272			
Dollars in thousands	Other Intangible Assets			December 31, 2017		
	September 30, 2018			September 30, 2017		
Identifiable intangible assets	Community Banking	Insurance Services	Total	Community Banking	Insurance Services	Total
Gross carrying amount	\$12,598	\$ 3,000	\$15,598	\$12,598	\$ 3,000	\$15,598
Less: accumulated amortization	2,368	2,250	4,618	1,257	2,100	3,357
Net carrying amount	\$10,230	\$ 750	\$10,980	\$11,341	\$ 900	\$12,241

We recorded amortization expense of \$1,261,000 and \$974,000 for the nine months ended September 30, 2018 and 2017, respectively, relative to our identifiable intangible assets.

Amortization relative to our identifiable intangible assets is expected to approximate the following during the next five years:

Dollars in thousands	Core Deposit	Customer
	Intangible	Intangible
2018	\$ 1,471	\$ 200
2019	1,368	200
2020	1,265	200
2021	1,162	200
2022	1,060	100

#### NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of September 30, 2018 and December 31, 2017:

Dollars in thousands	September 30, 2018	December 31, 2017
Demand deposits, interest bearing	\$ 505,411	\$ 410,606
Savings deposits	301,269	358,168
Time deposits	611,687	614,334
Total	\$ 1,418,367	\$ 1,383,108

Included in time deposits are deposits acquired through a third party (“brokered deposits”) totaling \$227.3 million and \$216.9 million at September 30, 2018 and December 31, 2017, respectively.

Table of Contents

29

---

A summary of the scheduled maturities for all time deposits as of September 30, 2018 is as follows:

Dollars in thousands

Three month period ending December 31, 2018	\$67,407
Year ending December 31, 2019	226,878
Year ending December 31, 2020	145,160
Year ending December 31, 2021	76,228
Year ending December 31, 2022	33,296
Thereafter	62,718
Total	\$611,687

The aggregate amount of time deposits in denominations that meet or exceed the FDIC insurance limit of \$250,000 totaled \$249.7 million at September 30, 2018 and \$239.6 million at December 31, 2017.

#### NOTE 10. BORROWED FUNDS

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

Dollars in thousands	Nine Months Ended September 30,			
	2018		2017	
	Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit	Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit
Balance at September 30	\$233,300	\$5,103	\$199,500	\$3,488
Average balance outstanding for the period	209,877	4,128	196,728	3,474
Maximum balance outstanding at any month end during period	262,000	7,534	229,300	3,488
Weighted average interest rate for the period	2.01 %	1.80 %	1.10 %	1.03 %
Weighted average interest rate for balances outstanding at September 30	2.41 %	2.25 %	1.32 %	1.25 %

Dollars in thousands	Year Ended December 31, 2017			
	Short-term FHLB Advances	Short-term Repurchase Agreements	Federal Funds Purchased and Lines of Credit	
Balance at December 31	\$247,000	\$ —	3,499	
Average balance outstanding for the period	201,712	519	3,512	
Maximum balance outstanding at any month end during period	247,000	—	3,499	
Weighted average interest rate for the period	1.19 %	0.12 %	1.10 %	
Weighted average interest rate for balances outstanding at December 31	1.60 %	— %	1.50 %	

Long-term borrowings: Our long-term borrowings of \$739.0 thousand and \$45.8 million at September 30, 2018 and December 31, 2017, respectively, consisted of advances from the Federal Home Loan Bank (“FHLB”) and structured repurchase agreements with unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

Table of Contents

30

---

	Balance at September 30,	Balance at December 31,
Dollars in thousands	2018	2017
Long-term FHLB advances	\$ 739	\$ 751
Long-term repurchase agreements	—	45,000
Total	\$ 739	\$ 45,751

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

The average interest rate paid on long-term borrowings and long-term repurchase agreements for the nine month period ended September 30, 2018 was 4.24% compared to 4.32% for the first nine months of 2017.

Subordinated debentures owed to unconsolidated subsidiary trusts: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the “capital securities”) for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the “debentures”). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled \$19.6 million at September 30, 2018 and December 31, 2017.

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

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

Dollars in thousands	Long-term borrowings	Subordinated debentures owed to unconsolidated subsidiary trusts
Year Ending December 31, 2018	\$ 4	\$ —
2019	18	—
2020	18	—
2021	20	—
2022	21	—
Thereafter	658	19,589
	\$ 739	\$ 19,589

#### NOTE 11. SHARE-BASED COMPENSATION

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

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

Under the 2014 LTIP and the Plans, stock options and SARs have generally been granted with an exercise price equal to the fair value of Summit's common stock on the grant date. We periodically grant employee stock options to individual employees. During first quarter 2017, we granted 53,309 SARs that become exercisable ratably over five years (20% per year) and expire ten years after the grant date and granted 34,306 SARS that become exercisable ratably over seven years (14.29% per year) and

Table of Contents

31

---



expire ten years after the grant date. There were no grants of stock options or SARs during the three or nine month periods ended September 30, 2018.

The fair value of our employee stock options and SARs granted under the Plans is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options and SARs granted but are not considered by the model. Because our employee stock options and SARs have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options and SARs at the time of grant. The assumptions used to value SARs granted during 2017 were as follows:

	5-year vesting SARs	7-year vesting SARs	
Risk-free interest rate	2.16	% 2.24	%
Expected dividend yield	1.45	% 1.45	%
Expected common stock volatility	60.05	% 59.60	%
Expected life	6.5 years	7.0 years	

We recognize compensation expense based on the estimated number of stock awards expected to actually vest, exclusive of the awards expected to be forfeited. During the first nine months of 2018 and 2017, our share-based compensation expense was \$292,000 and \$284,000 and the related deferred tax benefits were approximately \$70,000 and \$105,000.

A summary of activity in our Plans during the first nine months of 2018 and 2017 is as follows:

	For the Nine Months Ended September 30, 2018			
	Options/SARs	Aggregate Intrinsic Value	Remaining Contractual Term (Yrs.)	Weighted-Average Exercise Price
Outstanding, January 1	250,291			\$ 17.75
Granted	—			—
Exercised	(1,600 )			17.79
Forfeited	(3,200 )			25.50
Expired	—			—
Outstanding, September 30	245,491	\$ 1,645	6.62	\$ 17.65
Exercisable, September 30	109,324	\$ 898	5.55	\$ 15.77

	For the Nine Months Ended September 30, 2017			
	Options/SARs	Aggregate Intrinsic Value	Remaining Contractual Term (Yrs.)	Weighted-Average Exercise Price
Outstanding, January 1	217,857			\$ 13.56
Granted	87,615			26.01
Exercised	(2,000 )			6.21
Forfeited	—			—
Expired	—			—

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

Outstanding, September 30	303,472	\$ 2,604	7.11	\$ 17.20
---------------------------	---------	----------	------	----------

Exercisable, September 30	115,827	\$ 1,239	5.01	\$ 15.02
---------------------------	---------	----------	------	----------

Table of Contents

32

---

## NOTE 12. COMMITMENTS AND CONTINGENCIES

### Off-Balance Sheet Arrangements

We are a party to certain financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. The contract amounts of these instruments reflect the extent of involvement that we have in this class of financial instruments.

Many of our lending relationships contain both funded and unfunded elements. The funded portion is reflected on our balance sheet. The unfunded portion of these commitments is not recorded on our balance sheet until a draw is made under the loan facility. Since many of the commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements.

A summary of the total unfunded, or off-balance sheet, credit extension commitments follows:

Dollars in thousands	September 30, 2018
Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 69,263
Construction loans	92,280
Other loans	177,079
Standby letters of credit	6,092
Total	\$ 344,714

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

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

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

### Litigation

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

## NOTE 13. REGULATORY MATTERS

Our bank subsidiary, Summit Community Bank, Inc. ("Summit Community"), is subject to various regulatory capital requirements administered by the banking regulatory agencies. Under the capital adequacy guidelines and the

regulatory framework for prompt corrective action, Summit Community must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Our bank subsidiary's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Quantitative measures established by regulation to ensure capital adequacy require Summit Community to maintain minimum amounts and ratios of Common Equity Tier 1("CET1"), Total capital and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average

Table of Contents

33

---

assets (as defined). We believe, as of September 30, 2018, that our bank subsidiary met all capital adequacy requirements to which they were subject.

The most recent notifications from the banking regulatory agencies categorized Summit Community as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, Summit Community must maintain minimum CET1, Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below.

The Basel III Capital Rules became effective for us on January 1, 2015, with full compliance with all of the final rule's requirements phased-in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of September 30, 2018, Summit Community's capital levels remained characterized as "well-capitalized" under the new rules. See the Capital Requirements section included in Part I, Item 1 -- Business of our 2017 Annual Report on Form 10-K for further discussion of Basel III.

On August 28, 2018, the Federal Reserve Board (the "Board") issued an interim final rule expanding the applicability of the Board's small bank holding company policy statement, as required by the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018. The interim final rule raises the small bank holding company policy statement's asset threshold from \$1 billion to \$3 billion in total consolidated assets, and as a result, our holding company was exempted from all regulatory capital guidelines, to which it previously had been subject, until such time as its consolidated assets exceed \$3 billion.

The following table presents Summit's, as well as Summit Community's, actual and required minimum capital amounts and ratios as of September 30, 2018 and December 31, 2017 under the Basel III Capital Rules. The minimum required capital levels presented below reflect the minimum required capital levels (inclusive of the full capital conservation buffers) that will be effective as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

	Actual		Minimum Required Capital - Basel III Fully Phased-in		Minimum Required To Be Well Capitalized	
Dollars in thousands	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2018						
CET1 (to risk weighted assets)						
Summit	\$192,823	11.1%	N/A	N/A	N/A	N/A
Summit Community	207,725	12.0%	121,173	7.0 %	112,518	6.5 %
Tier I Capital (to risk weighted assets)						
Summit	211,823	12.2%	N/A	N/A	N/A	N/A
Summit Community	207,725	12.0%	147,139	8.5 %	138,483	8.0 %
Total Capital (to risk weighted assets)						
Summit	224,767	12.9%	N/A	N/A	N/A	N/A
Summit Community	220,669	12.7%	182,443	10.5 %	173,755	10.0 %
Tier I Capital (to average assets)						
Summit	211,823	10.1%	N/A	N/A	N/A	N/A
Summit Community	207,725	9.9 %	83,929	4.0 %	104,912	5.0 %

Table of Contents



	Actual		Minimum Required Capital - Basel III Fully Phased-in		Minimum Required To Be Well Capitalized	
Dollars in thousands	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017						
CET1 (to risk weighted assets)						
Summit	177,010	10.6%	116,893	7.0 %	108,544	6.5 %
Summit Community	195,008	11.7%	116,671	7.0 %	108,338	6.5 %
Tier I Capital (to risk weighted assets)						
Summit	196,010	11.8%	141,194	8.5 %	132,888	8.0 %
Summit Community	195,008	11.7%	141,672	8.5 %	133,339	8.0 %
Total Capital (to risk weighted assets)						
Summit	208,575	12.5%	175,203	10.5%	166,860	10.0%
Summit Community	207,573	12.5%	174,361	10.5%	166,058	10.0%
Tier I Capital (to average assets)						
Summit	196,010	9.4 %	83,409	4.0 %	104,261	5.0 %
Summit Community	195,008	9.4 %	82,982	4.0 %	103,728	5.0 %

## NOTE 14. SEGMENT INFORMATION

We operate three business segments: community banking, insurance services and trust and wealth management services. These segments are primarily identified by the products or services offered. The community banking segment consists of our full service banks which offer customers traditional banking products and services through various delivery channels. The insurance services segment includes two insurance agency offices that sell insurance products. The trust and wealth management segment includes Summit Community Bank's trust division and other non-bank investment products. The accounting policies discussed throughout the notes to the consolidated financial statements apply to each of our business segments.

Inter-segment revenue and expense consists of management fees allocated to the community banking, insurance services and trust and wealth management segments for all centralized functions that are performed by the parent, including overall direction in the areas of strategic planning, investment portfolio management, asset/liability management, financial reporting and other financial and administrative services. Information for each of our segments is included below:

	Three Months Ended September 30, 2018					
Dollars in thousands	Community Banking	Trust and Wealth Management	Insurance Services	Parent	Eliminations	Total
Net interest income	\$17,441	\$ —	\$ —	\$(228)	) \$ —	\$17,213
Provision for loan losses	500	—	—	—	—	500
Net interest income after provision for loan losses	16,941	—	—	(228)	) —	16,713
Other income	2,490	687	1,034	389	(389)	) 4,211
Other expenses	10,696	551	879	621	(389)	) 12,358
Income (loss) before income taxes	8,735	136	155	(460)	) —	8,566
Income tax expense (benefit)	1,677	33	43	(86)	) —	1,667
Net income (loss)	\$7,058	\$ 103	\$ 112	\$(374)	) \$ —	\$6,899

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

Inter-segment revenue (expense)	\$(359 )	\$ —	\$ (30 )	\$ 389	\$—	\$—
Average assets	\$2,130,483	\$ —	\$ 6,121	\$234,693	\$(257,897 )	\$2,113,400
Capital expenditures	\$1,411	\$ —	\$ 11	\$—	\$—	\$1,422

Table of Contents

35

---



## Three Months Ended September 30, 2017

Dollars in thousands	Community Banking	Trust and Wealth Management	Insurance Services	Parent	Eliminations	Total
Net interest income	\$17,408	\$ —	\$ —	\$(176)	) \$ —	\$17,232
Provision for loan losses	375	—	—	—	—	375
Net interest income after provision for loan losses	17,033	—	—	(176)	) —	16,857
Other income	2,408	589	1,003	491	(491)	) 4,000
Other expenses	10,844	546	814	734	(491)	) 12,447
Income (loss) before income taxes	8,597	43	189	(419)	) —	8,410
Income tax expense (benefit)	2,482	16	92	(110)	) —	2,480
Net income (loss)	\$6,115	\$ 27	\$ 97	\$(309)	) \$ —	\$5,930
Inter-segment revenue (expense)	\$(451)	) \$ —	\$(40)	) \$491	\$ —	\$ —
Average assets	\$2,110,832	\$ —	\$ 6,288	\$217,928	\$(246,788)	) \$2,088,260
Capital expenditures	\$1,497	\$ —	\$ —	\$ —	\$ —	\$1,497

## Nine Months Ended September 30, 2018

Dollars in thousands	Community Banking	Trust and Wealth Management	Insurance Services	Parent	Eliminations	Total
Net interest income	\$52,385	\$ —	\$ —	\$(640)	) \$ —	\$51,745
Provision for loan losses	1,750	—	—	—	—	1,750
Net interest income after provision for loan losses	50,635	—	—	(640)	) —	49,995
Other income	8,052	2,026	3,157	1,166	(1,166)	) 13,235
Other expenses	32,270	1,561	2,728	2,014	(1,166)	) 37,407
Income (loss) before income taxes	26,417	465	429	(1,488)	) —	25,823
Income tax expense (benefit)	5,251	112	111	(273)	) —	5,201
Net income (loss)	\$21,166	\$ 353	\$ 318	\$(1,215)	) \$ —	\$20,622
Inter-segment revenue (expense)	\$(1,077)	) \$ —	\$(89)	) \$1,166	\$ —	\$ —
Average assets	\$2,135,416	\$ —	\$ 6,059	\$229,597	\$(252,772)	) \$2,118,300
Capital expenditures	\$4,178	\$ —	\$ 24	\$86	\$ —	\$4,288

[Table of Contents](#)

Dollars in thousands	Nine Months Ended September 30, 2017					Total
	Community Banking	Trust and Wealth Management	Insurance Services	Parent	Eliminations	
Net interest income	\$49,220	\$ —	\$ —	\$(511)	) \$ —	\$48,709
Provision for loan losses	875	—	—	—	—	875
Net interest income after provision for loan losses	48,345	—	—	(511)	) —	47,834
Other income	6,280	1,284	2,932	1,473	(1,473)	) 10,496
Other expenses	41,351	1,219	2,495	1,807	(1,473)	) 45,399
Income (loss) before income taxes	13,274	65	437	(845)	) —	12,931
Income tax expense (benefit)	3,386	24	190	(261)	) —	3,339
Net income (loss)	\$9,888	\$ 41	\$ 247	\$(584)	) \$ —	\$9,592
Inter-segment revenue (expense)	\$(1,353)	) \$ —	\$(120)	) \$1,473	\$ —	\$ —
Average assets	\$1,994,042	\$ —	\$ 6,197	\$203,459	\$(232,211)	) \$1,971,487
Capital expenditures	\$5,544	\$ —	\$ 36	\$92	\$ —	\$5,672

#### NOTE 15. DERIVATIVE FINANCIAL INSTRUMENTS

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

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

A summary of our derivative financial instruments as of September 30, 2018 and December 31, 2017 follows:

Dollars in thousands	September 30, 2018			
	Notional Amount	Derivative Fair Value	Net Ineffective Hedge	Gains/(Losses)
		Asset	Liability	
<b>CASH FLOW HEDGES</b>				
Pay-fixed/receive-variable interest rate swaps				
Short term borrowings	\$110,000	\$ —	\$ 284	\$ —
<b>FAIR VALUE HEDGES</b>				
Pay-fixed/receive-variable interest rate swaps				
Commercial real estate loans	\$19,543	\$1,063	\$ —	\$ —

Table of Contents

37

---

	December 31, 2017			
	Notional Amount	Derivative Fair Value Asset Liability	Net Ineffective Hedge Gains/(Losses)	
Dollars in thousands				
<b>CASH FLOW HEDGES</b>				
Pay-fixed/receive-variable interest rate swaps				
Short term borrowings	\$ 110,000	\$ — \$ 2,057	\$	—
<b>FAIR VALUE HEDGES</b>				
Pay-fixed/receive-variable interest rate swaps				
Commercial real estate loans	\$ 19,965	\$ 312 \$ —	\$	—

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

## NOTE 16. ACQUISITIONS

### FCB Acquisition

On April 1, 2017, Summit Community Bank, Inc. ("SCB"), a wholly-owned subsidiary of Summit, acquired 100% of the ownership of First Century Bankshares, Inc. ("FCB") and its subsidiary First Century Bank, headquartered in Bluefield, West Virginia. FCB's assets and liabilities approximated \$406 million and \$361 million, respectively, at March 31, 2017.

The following presents the financial effects of adjustments recognized in the statement of income for the three months and nine months ended September 30, 2018 and 2017 related to business combinations that occurred during 2016 and 2017.

	Income increase (decrease)			
	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Dollars in thousands				
Interest and fees on loans	\$38	\$224	\$239	\$712
Interest expense on deposits	48	76	162	167
Amortization of intangibles	(363 )	(398 )	(1,111)	(825 )
Income before income tax expense	\$(277)	\$(98 )	\$(710)	\$54

### Pending Peoples Acquisition

On July 24, 2018, we entered into a Definitive Merger Agreement with Peoples Bankshares, Inc. ("Peoples"). Pursuant to the terms of the merger agreement, Summit will acquire all of the outstanding shares of common stock of Peoples in exchange for cash in the amount of \$47.00 per share or 1.7193 shares of Summit common stock. Peoples shareholders will have a right to receive cash, Summit's common stock or a combination of cash and Summit common stock, subject to proration to result in approximately 50% cash and 50% stock consideration in the aggregate. Total merger consideration received by Peoples shareholders is subject to an adjustment if Peoples' adjusted shareholders' equity as of the effective date of the merger deviates from the range mutually determined by the parties. Peoples' assets approximated \$134 million at September 30, 2018.

We anticipate the acquisition will close in the first quarter of 2019, subject to customary closing conditions, including regulatory approval and approval of Peoples' shareholders. Following the consummation of the merger, Peoples' wholly-owned subsidiary First Peoples Bank, Inc. will be consolidated with Summit's subsidiary, Summit Community Bank, Inc.

NOTE 17. ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

The following is changes in accumulated other comprehensive (loss) income by component, net of tax, for the three and nine months ending September 30, 2018 and 2017.

Table of Contents

38

---

Dollars in thousands	For the Three Months Ended September 30, 2018			
	Gains and Losses on Other Post- Retirement Benefits	Gains and Losses on Cash Flow Retirement Hedges	Unrealized Gains (Losses) on Available-for-Sale Securities	Total
Beginning balance	\$398	\$(472 )	\$ (912 )	\$(986 )
Other comprehensive income (loss) before reclassification	—	255	(2,168 )	(1,913 )
Amounts reclassified from accumulated other comprehensive income	—	—	(6 )	(6 )
Net current period other comprehensive income (loss)	—	255	(2,174 )	(1,919 )
Ending balance	\$398	\$(217 )	\$ (3,086 )	\$(2,905 )

Dollars in thousands	For the Three Months Ended September 30, 2017			
	Gains and Losses on Other Post- Retirement Benefits	Gains and Losses on Cash Flow Retirement Hedges	Unrealized Gains (Losses) on Available-for-Sale Securities	Total
Beginning balance	\$219	\$(2,238 )	\$ 1,712	\$(307 )
Other comprehensive income before reclassification	—	313	399	712
Amounts reclassified from accumulated other comprehensive income	—	—	(16 )	(16 )
Net current period other comprehensive income	—	313	383	696
Ending balance	\$219	\$(1,925 )	\$ 2,095	\$389

Dollars in thousands	For the Nine Months Ended September 30, 2018			
	Gains and Losses on Other Post- Retirement Benefits	Gains and Losses on Cash Flow Retirement Hedges	Unrealized Gains (Losses) on Available-for-Sale Securities	Total
Beginning balance	\$398	\$(1,564 )	\$ 2,898	\$1,732
Other comprehensive income (loss) before reclassification	—	1,347	(5,355 )	(4,008 )
Amounts reclassified from accumulated other comprehensive income	—	—	(629 )	(629 )
Net current period other comprehensive income (loss)	—	1,347	(5,984 )	(4,637 )
Ending balance	\$398	\$(217 )	\$ (3,086 )	\$(2,905 )

Dollars in thousands	For the Nine Months Ended September 30, 2017			
	Gains and Losses	Gains and Losses	Unrealized Gains (Losses) on Available-for-Sale	Total

	on	on	Cash	Securities	
	Other	Flow			
	Post-Retirement	Benefits			
Beginning balance	\$—	\$(2,905)	\$ (357	)	\$(3,262)
Other comprehensive income before reclassification	219	980	2,489		3,688
Amounts reclassified from accumulated other comprehensive income	—	—	(37	)	(37 )
Net current period other comprehensive income	219	980	2,452		3,651
Ending balance	\$219	\$(1,925)	\$ 2,095		\$389

Table of Contents

39

---

## NOTE 18. INCOME TAXES

Our income tax expense for the three months ended September 30, 2018 and September 30, 2017 totaled \$1.7 million and \$2.5 million, respectively. For the nine months ended September 30, 2018 and September 30, 2017 our income tax expense totaled \$5.2 million and \$3.3 million, respectively. Our effective tax rate (income tax expense as a percentage of income before taxes) for the quarters ended September 30, 2018 and 2017 was 19.5% and 29.5%, respectively, and for the nine months ended September 30, 2018 and 2017 were 20.1% and 25.8%, respectively. A reconciliation between the statutory income tax rate and our effective income tax rate for the three and nine months ended September 30, 2018 and 2017 is as follows:

	For the Three Months Ended September 30, 2018		For the Nine Months Ended September 30, 2017	
Dollars in thousands	Percent	Percent	Percent	Percent
Applicable statutory rate	21.0 %	35.0 %	21.0 %	35.0 %
Increase (decrease) in rate resulting from:				
Tax-exempt interest and dividends, net	(3.1) %	(5.1) %	(3.0) %	(8.8) %
State income taxes, net of Federal income tax benefit	2.1 %	1.8 %	2.2 %	1.8 %
Low-income housing and rehabilitation tax credits	(0.9) %	(2.3) %	(1.1) %	(1.5) %
Other, net	0.4 %	0.1 %	1.0 %	(0.7) %
Effective income tax rate	19.5 %	29.5 %	20.1 %	25.8 %

The components of applicable income tax expense for the three and nine months ended September 30, 2018 and 2017 are as follows:

	For the Three Months Ended September 30, 2018		For the Nine Months Ended September 30, 2017	
Dollars in thousands	2018	2017	2018	2017
Current				
Federal	\$1,410	\$2,436	\$4,628	\$3,315
State	228	251	737	388
	1,638	2,687	5,365	3,703
Deferred				
Federal	25	(190)	(142)	(333)
State	4	(17)	(22)	(31)
	29	(207)	(164)	(364)
Total	\$1,667	\$2,480	\$5,201	\$3,339

## NOTE 19. REVENUE FROM CONTRACTS WITH CUSTOMERS

Interest income, loan fees, realized securities gains and losses, bank owned life insurance income and mortgage banking revenue are not in the scope of ASC Topic 606, Revenue from Contracts with Customers. With the exception of gains or losses on sales of foreclosed properties, all of our revenue from contracts with customers in the scope of ASC 606 is recognized within Noninterest Income in the Consolidated Statements of Income. Incremental costs of obtaining a contract are expensed when incurred when the amortization period is one year or less.

As of September 30, 2018, remaining performance obligations consisted of insurance products with an original expected length of one year or less.

A description of our significant sources of revenue accounted for under ASC 606 follows:

Service fees on deposit accounts are fees we charge our deposit customers for transaction-based, account maintenance and overdraft services. Transaction-based fees, which are earned based on specific transactions or customer activity



within a customer's deposit account, are recognized at the time the related transaction or activity occurs, as it is at this point when we fulfill the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which Summit satisfied the performance obligation. Overdraft fees are recognized when the overdraft occurs. Service fees on deposit accounts are paid through a direct charge to the customer's account.

Table of Contents

40

---

Bank card revenue is comprised of interchange revenue and ATM fees. Interchange revenue is earned when Summit's debit and credit cardholders conduct transactions through Mastercard and other payment networks. Interchange fees represent a percentage of the underlying cardholder's transaction value and are generally recognized daily, concurrent with the transaction processing services provided to the cardholder. ATM fees are earned when a non-Summit cardholder uses a Summit ATM. ATM fees are recognized daily, as the related ATM transactions are settled.

Trust and wealth management fees consist of 1) trust fees and 2) commissions earned from an independent, third-party broker-dealer. We earn trust fees from our contracts with trust clients to administer or manage assets for investment. Trust fees are earned over time (generally monthly) as Summit provides the contracted services and are assessed based on the value of assets under management at each month-end. We earn commissions from investment brokerage services provided to our clients by an independent, third-party broker-dealer. We receive monthly commissions from the third-party broker-dealer based upon client activity for the previous month.

Insurance commissions principally consist of commissions we earn as agents of insurers for selling group employee benefit and property and casualty insurance products to clients. Group employee benefit insurance commissions are recognized over time (generally monthly) as the related customary implied servicing obligations of group policyholders are fulfilled. Property and casualty insurance commissions are recognized using methods which approximate the time of placement of the underlying policy. We are paid insurance commissions ratably as the related policy premiums are paid by clients.

The following table illustrates our total non-interest income segregated by revenues within the scope of ASC Topic 606 and those which are within the scope of other ASC Topics:

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Dollars in thousands		
Service fees on deposit accounts	\$ 1,215	\$ 3,421
Bank card revenue	793	2,343
Trust and wealth management fees	687	2,026
Insurance commissions	1,062	3,188
Other	53	189
Net revenue from contracts with customers	3,810	11,167
Non-interest income within the scope of other ASC topics	401	2,068
Total noninterest income	\$ 4,211	\$ 13,235

Gain or loss on sale of foreclosed properties is recorded when control of the property transfers to the buyer, which generally occurs at the time of transfer of the deed. If Summit finances the sale of a foreclosed property to the buyer, we assess whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the foreclosed property is derecognized and the gain or loss on sale is recorded upon transfer of control of the property to the buyer. For the three and nine months ended September 30, 2018, net losses on sales of foreclosed properties were \$(18,000) and \$(11,800) .

[Table of Contents](#)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

The following discussion and analysis focuses on significant changes in our financial condition and results of operations of Summit Financial Group, Inc. ("Company" or "Summit") and its operating subsidiaries, Summit Community Bank ("Summit Community") and Summit Insurance Services, LLC, for the periods indicated. See Note 14 of the accompanying consolidated financial statements for our segment information. This discussion and analysis should be read in conjunction with our 2017 audited financial statements and Annual Report on Form 10-K.

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

OVERVIEW

On April 1, 2017, we acquired First Century Bankshares, Inc. ("FCB") and its subsidiary, First Century Bank, headquartered in Bluefield, West Virginia. FCB's results are included in our financial statements from the acquisition date forward, significantly impacting comparisons to the prior-year nine-month period.

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.

Primarily due to our FCB acquisition and organic loan growth, average interest earning assets increased by 7.76% for the first nine months in 2018 compared to the same period of 2017 while our net interest earnings on a tax equivalent basis increased 4.48%. Our tax equivalent net interest margin decreased 11 basis points as our yield on interest earning assets increased 16 basis points while our cost of interest bearing funds increased 34 basis points.

We recorded a charge of \$9.9 million, or \$6.2 million after-tax, to noninterest expense in the first quarter of 2017 to recognize our full resolution of the ResCap Litigation which had been pending since 2014.

BUSINESS SEGMENT RESULTS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
Dollars in thousands	2018	2017	2018	2017
Community banking	\$7,058	\$6,115	\$21,166	\$9,888
Trust and wealth management	103	27	353	41
Insurance services	112	97	318	247
Parent	(374 )	(309 )	(1,215 )	(584 )
Consolidated net income	\$6,899	\$5,930	\$20,622	\$9,592

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.

Table of Contents

42

---

Our most significant accounting policies are presented in the notes to the consolidated financial statements of our 2017 Annual Report on Form 10-K. These policies, along with the other disclosures presented in the financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

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

For additional information regarding critical accounting policies, refer to Critical Accounting Policies section in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2017 Form 10-K. There have been no significant changes in our application of critical accounting policies since December 31, 2017.

## RESULTS OF OPERATIONS

### Earnings Summary

Net income for the nine months ended September 30, 2018 increased to \$20.6 million or \$1.66 per diluted share from \$9.6 million or \$0.81 per diluted share for the same period of 2017. Net income for the three months ended September 30, 2018 was \$6.9 million, or \$0.55 per diluted share, compared to \$5.9 million, or \$0.48 per diluted share for the same period of 2017. The lower earnings for the nine months ended September 30, 2017 were primarily attributable to the charge for a \$9.9 million pre-tax litigation settlement recognized in the first quarter of 2017. Otherwise, net income for the nine months ended September 30, 2018, compared to the same period of 2017, was positively impacted by increased net interest income, increased fee income including trust and wealth management fees and fees related to deposit accounts, larger gains on sales of securities and fewer merger expenses being incurred during 2018 while being negatively impacted by generally higher operating expenses due to the FCB acquisition. Net income for the quarter ended September 30, 2018, compared to the same period of 2017, was positively impacted by increased fee income including trust and wealth management fees and fees related to deposit accounts. Returns on average equity and assets for the first nine months of 2018 were 13.28% and 1.30%, respectively, compared with 7.06% and 0.65% for the same period of 2017.

FCB's results of operations are included in our consolidated results of operations from the date of acquisition, and therefore our nine months ended September 30, 2018 results reflect increased levels of average balances, income and expense as compared to the same periods of 2017 results. At consummation (prior to fair value acquisition adjustments), FCB had total assets of \$406.2 million, net loans of \$226.5 million, and deposits of \$349.7 million.

### Net Interest Income

Net interest income is the principal component of our earnings and represents the difference between interest and fee income generated from earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates as well as changes in the volume and mix of earning assets and interest bearing liabilities can materially impact net interest income. Due to increases in interest earnings assets and interest bearing liabilities from the FCB acquisition and recent FOMC increases to its target Federal funds rate, we have experienced higher levels of net interest income but a decreased net interest margin for the nine months ended September 30, 2018 compared to September 30, 2017.

Q3 2018 compared to Q2 2018

For the quarter ended September 30, 2018, our net interest income on a fully taxable-equivalent basis decreased \$44,000 to \$17.55 million compared to \$17.60 million for the quarter end June 30, 2018. Our taxable-equivalent earnings on interest earning assets increased \$420,000, while the cost of interest bearing liabilities increased \$464,000 (see Tables I and II).

For the three months ended September 30, 2018 average interest earning assets remained unchanged at \$1.97 billion compared to the three months ended June 30, 2018, while average interest bearing liabilities also remained unchanged at \$1.67 billion for the three months ended June 30, 2018 and for the three months ended September 30, 2018.

For the quarter ended September 30, 2018, our net interest margin decreased to 3.53%, compared to 3.58% for the linked quarter, as the yields on earning assets increased 3 basis points, while the cost of our interest bearing funds increased by 10 basis points.

Table of Contents

43

---

Excluding the impact of accretion and amortization of fair value acquisition accounting adjustments related to the interest earning assets and interest bearing liabilities acquired by merger, Summit's net interest margin was 3.51% and 3.56% for the three months ended September 30, 2018 and June 30, 2018.

#### Q3 2018 compared to Q3 2017

For the quarter ended September 30, 2018, our net interest income on a fully taxable-equivalent basis decreased \$334,000 to \$17.55 million compared to \$17.89 million for the quarter end September 30, 2017. Our taxable-equivalent earnings on interest earning assets increased \$1.4 million, while the cost of interest bearing liabilities increased \$1.8 million (see Tables I and II).

For the three months ended September 30, 2018 average interest earning assets increased 1.4% to \$1.97 billion compared to \$1.94 billion for the three months ended September 30, 2017, while average interest bearing liabilities increased 0.5% from \$1.66 billion for the three months ended September 30, 2017 to \$1.67 billion for the three months ended September 30, 2018.

For the quarter ended September 30, 2018, our net interest margin decreased to 3.53%, compared to 3.65% for the same period of 2017, as the yields on earning assets increased 23 basis points, while the cost of our interest bearing funds increased by 42 basis points. The yields on earning assets increased at a slower pace primarily due to lower taxable-equivalent yields on tax-exempt interest earning assets resulting from reduction in the corporate income tax rate upon enactment of Tax Cuts and Jobs Act ("TCJA").

Excluding the impact of accretion and amortization of fair value acquisition accounting adjustments related to the interest earning assets and interest bearing liabilities acquired by merger, Summit's net interest margin was 3.51% and 3.59% for the three months ended September 30, 2018 and 2017.

#### Table of Contents

44

---

Table I - Average Balance Sheet and Net Interest Income Analysis

Dollars in thousands	For the Quarter Ended								
	September 30, 2018			June 30, 2018			September 30, 2017		
	Average Balance	Earnings/Expense	Yield/Rate	Average Balance	Earnings/Expense	Yield/Rate	Average Balance	Earnings/Expense	Yield/Rate
Interest earning assets									
Loans, net of unearned fees (1)									
Taxable	\$1,615,700	\$21,154	5.19 %	\$1,618,726	\$20,820	5.16 %	\$1,539,945	\$19,387	4.99 %
Tax-exempt (2)	15,688	178	4.50 %	15,800	180	4.57 %	16,314	158	3.84 %
Securities									
Taxable	155,574	1,227	3.13 %	160,632	1,240	3.10 %	198,913	1,283	2.56 %
Tax-exempt (2)	146,174	1,443	3.92 %	136,984	1,346	3.94 %	145,599	1,714	4.67 %
Federal funds sold and interest bearing deposits with other banks	38,642	138	1.42 %	38,936	134	1.38 %	42,926	149	1.38 %
Total interest earning assets	1,971,778	24,140	4.86 %	1,971,078	23,720	4.83 %	1,943,697	22,691	4.63 %
Noninterest earning assets									
Cash & due from banks	9,326			9,100			9,591		
Premises and equipment	36,533			35,721			33,667		
Property held for sale	21,591			21,435			23,185		
Other assets	87,037			86,638			90,538		
Allowance for loan losses	(12,865 )			(12,541 )			(12,418 )		
Total assets	\$2,113,400			\$2,111,431			\$2,088,260		
Interest bearing liabilities									
Interest bearing demand deposits	\$486,107	\$1,168	0.95 %	\$457,016	\$901	0.79 %	\$384,539	\$323	0.33 %
Savings deposits	312,467	857	1.09 %	332,809	798	0.96 %	365,150	637	0.69 %
Time deposits	616,657	2,689	1.73 %	640,626	2,610	1.63 %	636,424	2,003	1.25 %
Short-term borrowings	211,211	1,436	2.70 %	187,475	1,242	2.66 %	205,536	1,160	2.24 %
Long-term borrowings and capital trust securities	39,265	437	4.42 %	52,147	572	4.40 %	65,346	681	4.13 %
Total interest bearing liabilities	1,665,707	6,587	1.57 %	1,670,073	6,123	1.47 %	1,656,995	4,804	1.15 %
Noninterest bearing liabilities and shareholders' equity									
Demand deposits	219,986			219,134			217,760		
Other liabilities	15,447			15,608			17,414		
Total liabilities	1,901,140			1,904,815			1,892,169		
Shareholders' equity	212,260			206,616			196,091		
	\$2,113,400			\$2,111,431			\$2,088,260		



Total liabilities and  
shareholders' equity

Net interest earnings	\$ 17,553	\$ 17,597	\$ 17,887
Net yield on interest earning assets	3.53 %	3.58 %	3.65 %

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

- Interest income on tax-exempt securities and loans has been adjusted assuming a Federal tax rate of 21% for the three months ended September 30, 2018 and June 30, 2018 and 35% for the three months ended September 30, 2017. The tax equivalent adjustment resulted in an increase in interest income of \$340,000, \$322,000, and \$655,000 for the three months ended September 30, 2018, June 30, 2018, and September 30, 2017, respectively.

Table of Contents

45

---

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

	For the Quarter Ended			For the Quarter Ended		
	September 30, 2018 vs. June 30, 2018			September 30, 2018 vs. September 30, 2017		
	Increase (Decrease) Due to Change in:			Increase (Decrease) Due to Change in:		
Dollars in thousands	Volume	Rate	Net	Volume	Rate	Net
Interest earned on:						
Loans						
Taxable	\$10	\$324	\$334	\$975	\$792	\$1,767
Tax-exempt	—	(2)	(2)	(6)	26	20
Securities						
Taxable	(29)	16	(13)	(311)	255	(56)
Tax-exempt	104	(7)	97	7	(278)	(271)
Federal funds sold and interest bearing deposits with other banks	(1)	5	4	(15)	4	(11)
Total interest earned on interest earning assets	84	336	420	650	799	1,449
Interest paid on:						
Interest bearing demand deposits	63	204	267	105	740	845
Savings deposits	(48)	107	59	(103)	323	220
Time deposits	(90)	169	79	(64)	750	686
Short-term borrowings	173	21	194	33	243	276
Long-term borrowings and capital trust securities	(137)	2	(135)	(288)	44	(244)
Total interest paid on interest bearing liabilities	(39)	503	464	(317)	2,100	1,783
Net interest income	\$123	\$(167)	\$(44)	\$967	\$(1,301)	\$(334)

[Table of Contents](#)

Table III - Average Balance Sheet and Net Interest Income Analysis

Dollars in thousands	For the Nine Months Ended					
	September 30, 2018			September 30, 2017		
	Average Balance	Earnings/Expense	Yield/Rate	Average Balance	Earnings/Expense	Yield/Rate
Interest earning assets						
Loans, net of unearned fees (1)						
Taxable	\$1,615,427	\$ 62,196	5.15 %	\$1,452,840	\$ 54,487	5.01 %
Tax-exempt (2)	15,929	542	4.55 %	14,223	602	5.66 %
Securities						
Taxable	169,177	3,839	3.03 %	199,995	3,742	2.50 %
Tax-exempt (2)	138,539	4,078	3.94 %	124,860	4,392	4.70 %
Federal funds sold and interest bearing deposits with other banks	39,075	412	1.41 %	43,862	466	1.42 %
Total interest earning assets	1,978,147	71,067	4.80 %	1,835,780	63,689	4.64 %
Noninterest earning assets						
Cash & due from banks	9,459			8,071		
Premises and equipment	35,620			30,904		
Property held for sale	21,452			24,393		
Other assets	86,337			84,390		
Allowance for loan losses	(12,715 )			(12,051 )		
Total assets	\$2,118,300			\$1,971,487		
Interest bearing liabilities						
Interest bearing demand deposits	\$455,637	\$ 2,701	0.79 %	\$342,358	\$ 722	0.28 %
Savings deposits	330,420	2,373	0.96 %	365,068	1,879	0.69 %
Time deposits	626,587	7,498	1.60 %	602,175	5,386	1.20 %
Short-term borrowings	214,005	4,084	2.55 %	200,929	3,233	2.15 %
Long-term borrowings and capital trust securities	52,155	1,696	4.35 %	65,725	2,012	4.09 %
Total interest bearing liabilities	1,678,804	18,352	1.46 %	1,576,255	13,232	1.12 %
Noninterest bearing liabilities and shareholders' equity						
Demand deposits	216,701			196,019		
Other liabilities	15,778			17,990		
Total liabilities	1,911,283			1,790,264		
Shareholders' equity - common	207,017			181,223		
Total liabilities and shareholders' equity	\$2,118,300			\$1,971,487		
Net interest earnings		\$ 52,715			\$ 50,457	
Net yield on interest earning assets			3.56 %			3.67 %

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

- (2) - Interest income on tax-exempt securities and loans has been adjusted assuming a Federal tax rate of 21% and 35% for the nine months ended September 30, 2018 and 2017, respectively. The tax equivalent adjustment resulted in an increase in interest income of \$970,000 and \$1,748,000 for the nine months ended September 30, 2018 and 2017, respectively.

Table of Contents

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

	For the Nine Months Ended September 30, 2018 versus September 30, 2017 Increase (Decrease) Due to Change in:		
Dollars in thousands	Volume	Rate	Net
Interest earned on:			
Loans			
Taxable	\$6,229	\$1,480	\$7,709
Tax-exempt	67	(127)	(60)
Securities			
Taxable	(629)	726	97
Tax-exempt	449	(763)	(314)
Federal funds sold and interest bearing deposits with other banks	(51)	(3)	(54)
Total interest earned on interest earning assets	6,065	1,313	7,378
Interest paid on:			
Interest bearing demand deposits	306	1,673	1,979
Savings deposits	(192)	686	494
Time deposits	226	1,886	2,112
Short-term borrowings	220	631	851
Long-term borrowings and capital trust securities	(435)	119	(316)
Total interest paid on interest bearing liabilities	125	4,995	5,120
Net interest income	\$5,940	\$(3,682)	\$2,258

## Noninterest Income

Total noninterest income for the nine months ended September 30, 2018 increased 26.1% compared to same period in 2017 principally due to increased trust and wealth management fees and service fees on deposit accounts as a result of the FCB acquisition and increased gains on sales of securities. Further detail regarding noninterest income is reflected in the following table.

Table III - Noninterest Income

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
Dollars in thousands	2018	2017	2018	2017
Insurance commissions	\$1,062	\$1,043	\$3,188	\$3,000
Trust and wealth management fees	687	589	2,026	1,284
Service charges on deposit accounts	1,215	1,162	3,421	2,910
Bank card revenue	793	738	2,343	1,955
Realized securities gains	8	26	828	58
Bank owned life insurance income	250	255	773	758
Other	196	187	656	531
Total	\$4,211	\$4,000	\$13,235	\$10,496

## Noninterest Expense

Total noninterest expense was nearly unchanged for the quarter ended September 30, 2018 compared to the quarter ended September 30, 2017. Total noninterest expense decreased 17.6% for the nine months ended September 30, 2018, as compared to the same period in 2017. Excluding the \$9.9 million litigation charge during 2017, total noninterest expense increased 5.4%

Table of Contents

48

---

with higher salaries, commissions, and employee benefits having the largest negative impact and fewer merger expenses during 2018 having the largest positive impact. Table VI below shows the breakdown of the changes.

Table VI - Noninterest Expense

Dollars in thousands	For the Quarter Ended September 30,				For the Nine Months Ended September 30,			
	2018	Change		2017	2018	Change		2017
		\$	%			\$	%	
Salaries, commissions, and employee benefits	\$6,806	\$196	3.0	% \$6,610	\$20,550	\$1,995	10.8	% \$18,555
Net occupancy expense	856	9	1.1	% 847	2,528	289	12.9	% 2,239
Equipment expense	1,118	25	2.3	% 1,093	3,271	412	14.4	% 2,859
Professional fees	503	130	34.9	% 373	1,222	210	20.8	% 1,012
Advertising and public relations	170	33	24.1	% 137	461	68	17.3	% 393
Amortization of intangibles	413	(35 )	(7.8 )	% 448	1,261	287	29.5	% 974
FDIC premiums	210	(100 )	(32.3 )	% 310	690	(125 )	(15.3 )	% 815
Bank card expense	384	(11 )	(2.8 )	% 395	1,080	(33 )	(3.0 )	% 1,113
Foreclosed properties expense, net of losses	169	(64 )	(27.5 )	% 233	843	19	2.3	% 824
Litigation settlement	—	—	—	% —	—	(9,900 )	N/A	9,900
Merger-related expenses	86	75	(100.0 )	% 11	86	(1,489 )	N/A	1,575
Other	1,643	(347 )	(17.4 )	% 1,990	5,415	275	5.4	% 5,140
Total	\$12,358	\$(89 )	(0.7 )	% \$12,447	\$37,407	\$(7,992)	(17.6 )	% \$45,399

Salaries, commissions, and employee benefits: These expenses are 10.8% higher in the first nine months of 2018 compared to first nine months of 2017 due to an increase in number of employees, primarily those in conjunction with the FCB acquisition, and general merit raises.

Net occupancy expense: The increase in net occupancy expense for the nine months ended September 30, 2018 is primarily due to the acquired FCB locations.

Equipment: The increase in equipment expense is primarily increased depreciation and amortization related to various technological upgrades, both hardware and software, made during the past two years and also the FCB acquisition in Q2 2017.

Amortization of intangibles: Amortization of intangibles increased for the nine months ended September 30, 2018 as a result of the additional amortization of the core deposit intangible associated with the FCB acquisition.

Litigation settlement: We recorded a \$9.9 million pre-tax charge in Q1 2017 as full resolution of the ResCap Litigation which had been pending since 2014.

Other: The increase in other expenses for the nine months ended September 30, 2018 is primarily due to increased operating expenses as a result of the acquisition of FCB.

## Income Taxes

Our income tax expense for the three months ended September 30, 2018 and September 30, 2017 totaled \$1.7 million and \$2.5 million, respectively. For the nine months ended September 30, 2018 and September 30, 2017 our income tax expense totaled \$5.2 million and \$3.3 million, respectively. Our effective tax rate (income tax expense as a percentage of income before taxes) for the quarters ended September 30, 2018 and 2017 was 19.5% and 29.5%, respectively and for the nine months ended September 30, 2018 and September 30, 2017 was 20.1% and 25.8%. This decrease in effective rate is primarily attributable to the recent enactment of the TCJA and our increased portfolio of

tax-exempt municipal securities. Refer to Note 18 on page 38 for further information regarding our income taxes.

#### Credit Experience

For purposes of this discussion, nonperforming assets include foreclosed properties, other repossessed assets, and nonperforming loans, which is comprised of loans 90 days or more past due and still accruing interest and nonaccrual loans. Performing TDRs are excluded from nonperforming loans.

#### Table of Contents

49

---

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

We recorded \$1,750,000 and \$875,000 provision for loan losses for the first nine months of 2018 and 2017. The increase is primarily due to recent higher loss experience.

As illustrated in Table VII below, our non-performing assets have increased since year end 2017.

Table VII - Summary of Non-Performing Assets

	September 30,		December 31,
Dollars in thousands	2018	2017	2017
Accruing loans past due 90 days or more	\$2,215	\$35	\$274
Nonaccrual loans			
Commercial	801	757	696
Commercial real estate	3,099	2,773	2,927
Commercial construction and development	—	—	—
Residential construction and development	3,200	3,931	3,569
Residential real estate	7,575	8,082	7,656
Consumer	80	494	201
Total nonaccrual loans	14,755	16,037	15,049
Foreclosed properties			
Commercial	—	—	—
Commercial real estate	1,762	1,988	1,789
Commercial construction and development	6,790	7,392	7,392
Residential construction and development	11,614	11,852	11,182
Residential real estate	1,851	1,390	1,107
Total foreclosed properties	22,017	22,622	21,470
Reposessed assets	5	12	68
Total nonperforming assets	\$38,992	\$38,706	\$36,861
Total nonperforming loans as a percentage of total loans	1.03	% 1.02	% 0.95
Total nonperforming assets as a percentage of total assets	1.82	% 1.84	% 1.73
Allowance for loan losses as a percentage of nonperforming loans	76.28	% 77.56	% 82.00
Allowance for loan losses as a percentage of period end loans	0.79	% 0.79	% 0.78

The following table details the activity regarding our foreclosed properties for the three and nine months ended September 30, 2018 and 2017.

Table VIII - Foreclosed Property Activity

	For the Three Months Ended		For the Nine Months Ended	
Dollars in thousands	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Beginning balance	\$21,606	\$23,592	\$21,470	\$24,504
Acquisitions	622	157	1,525	2,723
Improvements	323	50	1,118	269
Disposals	(496)	(1,086)	(1,638)	(4,336)
Writedowns to fair value	(38)	(91)	(458)	(538)
Balance September 30	\$22,017	\$22,622	\$22,017	\$22,622



Refer to Note 6 of the accompanying consolidated financial statements for information regarding our past due loans, impaired loans, nonaccrual loans, and troubled debt restructurings and to Note 8 of the notes to the consolidated financial statements of our 2017 Annual Report on Form 10-K for a summary of the methodology we employ on a quarterly basis to evaluate the overall adequacy of our allowance for loan losses.

Table of Contents

50

---

Substantially all of our nonperforming loans are secured by real estate. The 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. The fair values of the underlying collateral value or the discounted cash flows remain in excess of the recorded investment in many of our nonperforming loans and therefore, no specific reserve allocation is required.

At September 30, 2018 and December 31, 2017, our allowance for loan losses totaled \$12.9 million, or 0.79% of total loans and \$12.6 million, or 0.78% of total loans. If loans acquired by merger are excluded, the allowance for loan losses to total loans ratio at September 30, 2018 and December 31, 2017 would have been 0.87% and 0.91%, respectively. The allowance for loan losses is considered adequate to cover our current estimate of probable credit losses inherent in our loan portfolio.

At September 30, 2018 and December 31, 2017 we had approximately \$22.0 million and \$21.5 million in foreclosed properties which were 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 additional gains or losses.

## FINANCIAL CONDITION

Our total assets were \$2.14 billion at September 30, 2018 and \$2.13 billion at December 31, 2017. Table IX below is a summary of significant changes in our financial position between December 31, 2017 and September 30, 2018.

Table IX - Summary of Significant Changes in Financial Position

	Balance December 31, 2017	Increase (Decrease)	Balance September 30, 2018
Dollars in thousands			
Assets			
Cash and cash equivalents	\$52,631	\$ 1,203	\$53,834
Securities available for sale	328,723	(40,683 )	288,040
Other investments	14,934	(702 )	14,232
Loans, net	1,593,744	39,003	1,632,747
Property held for sale	21,470	547	22,017
Premises and equipment	34,209	2,679	36,888
Goodwill and other intangibles	27,513	(1,261 )	26,252
Cash surrender value of life insurance policies	41,358	850	42,208
Other assets	19,658	2,851	22,509
Total Assets	\$2,134,240	\$ 4,487	\$2,138,727
Liabilities			
Deposits	\$1,600,601	\$ 50,463	\$1,651,064
Short-term borrowings	250,499	(12,096 )	238,403
Long-term borrowings	45,751	(45,012 )	739
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	—	19,589
Other liabilities	16,295	(919 )	15,376
Shareholders' Equity	201,505	12,051	213,556
Total liabilities and shareholders' equity	\$2,134,240	\$ 4,487	\$2,138,727

The following is a discussion of the significant changes in our financial position during the first nine months of 2018:

Securities available for sale: The net decrease of \$40.7 million in securities available for sale is principally a result of sales of our lowest yielding mortgage-backed and municipal securities which funded loan growth, primarily in the commercial real estate portfolio.

Loans: Excluding mortgage warehouse lines of credit, loans grew \$34.2 million during the nine months ended September 30, 2018, primarily in the commercial real estate portfolio.

Table of Contents

51

---

**Deposits and short-term borrowings:** The net change in our deposits during the first nine months of 2018 resulted primarily from a net increase of \$25 million in brokered certificates of deposit issued strategically prior to anticipated higher funding costs, \$95 million growth in interest bearing checking accounts (primarily our indexed T-fund checking product), a \$26 million reduction in direct certificates of deposit and \$57 million decline in savings accounts. This net increase in deposits was used to pay off short-term FHLB advances.

**Long-term borrowings:** The decline in long-term borrowings resulted from the maturity of a long-term repurchase agreement during May 2018.

**Shareholders' equity:** Changes in shareholders' equity are a result of net income, other comprehensive income and dividends.

Refer to Notes 5, 6, 9, and 10 of the notes to the accompanying consolidated financial statements for additional information with regard to changes in the composition of our securities, loans, deposits and borrowings between September 30, 2018 and December 31, 2017.

## LIQUIDITY AND CAPITAL RESOURCES

Liquidity reflects our ability to ensure the availability of adequate funds to meet loan commitments and deposit withdrawals, as well as provide for other transactional requirements. Liquidity is provided primarily by funds invested in cash and due from banks (net of float and reserves), Federal funds sold, non-pledged securities, and available lines of credit with the Federal Home Loan Bank of Pittsburgh ("FHLB") and Federal Reserve Bank of Richmond, which totaled approximately \$916 million or 42.84% of total consolidated assets at September 30, 2018.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit activity. As a member of the FHLB, we have access to approximately \$758 million. As of September 30, 2018 and December 31, 2017, these advances totaled approximately \$234 million and \$248 million, respectively. At September 30, 2018, we had additional borrowing capacity of \$524 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 September 30, 2018 was approximately \$146 million, which is secured by a pledge of our consumer and commercial and industrial loan portfolios. We have a \$6 million unsecured line of credit with a correspondent bank. 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.

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

One of our continuous goals is maintenance of a strong capital position. Through management of our capital resources, we seek to provide an attractive financial return to our shareholders while retaining sufficient capital to

support future growth. Shareholders' equity at September 30, 2018 totaled \$213.6 million compared to \$201.5 million at December 31, 2017.

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

Table of Contents

52

---

## CONTRACTUAL CASH OBLIGATIONS

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at September 30, 2018.

Table X - Contractual Cash Obligations

Dollars in thousands	Long Term Debt	Capital Trust Securities	Operating Leases
2018	\$4	\$—	\$ 65
2019	18	—	200
2020	18	—	53
2021	20	—	31
2022	21	—	32
Thereafter	658	19,589	106
Total	\$739	\$19,589	\$ 487

## OFF-BALANCE SHEET ARRANGEMENTS

We are involved with some off-balance sheet arrangements that have or are reasonably likely to have an effect on our financial condition, liquidity, or capital. These arrangements at September 30, 2018 are presented in the following table.

Table XI - Off-Balance Sheet Arrangements	September 30, 2018
Dollars in thousands	
Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 69,263
Construction loans	92,280
Other loans	177,079
Standby letters of credit	6,092
Total	\$ 344,714

Table of Contents

53

---

## Item 3. 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 imbedded options. The principal objective of asset/liability management is to minimize interest rate risk and our actions in this regard are taken under the guidance of our Asset/Liability Management Committee (“ALCO”), which is comprised of members of senior management and members of the Board of Directors. The ALCO actively formulates the economic assumptions that we use in our financial planning and budgeting process and establishes policies which control and monitor our sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position is well-matched over the near-term. That is, absent any changes in the volumes of our interest earning assets or interest bearing liabilities, assets are likely to reprice faster than liabilities, resulting in an increase in net income in a rising rate environment. Net income would decrease in a falling interest rate environment. Net income is also subject to changes in the shape of the yield curve. In general, a flattening yield curve would decrease our earnings due to the compression of earning asset yields and funding rates, while a steepening would increase earnings as margins widen.

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

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of September 30, 2018. 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 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.

Change in Interest Rates	Estimated % Change in Net Interest Income over:			
	0 - 12		13 - 24	
	Months		Months	
	Actual	Actual	Actual	Actual
Down 100 basis points (1)	0.60	%	1.67	%
Up 200 basis points (1)	-0.80	%	0.20	%
Up 400 basis points (2)	-0.61	%	-3.20	%

- (1) assumes a parallel shift in the yield curve over 12 months, with no change thereafter
- (2) assumes a parallel shift in the yield curve over 24 months

Table of Contents

54

---



Item 4. Controls and Procedures

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of September 30, 2018, an evaluation of the effectiveness of disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of September 30, 2018 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

55

---

Part II. Other Information

Item 1. Legal Proceedings

Refer to Note 12 of the Notes to the Consolidated Financial Statements in Part I, Item 1 for information regarding legal proceedings not reportable under this Item.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 6. Exhibits

Exhibit  
3.i Amended and Restated Articles of Incorporation of Summit Financial Group, Inc.

Exhibit  
3.ii Articles of Amendment 2009

Exhibit  
3.iii Articles of Amendment 2011

Exhibit  
3.iv Amended and Restated By-Laws of Summit Financial Group, Inc.

Exhibit  
11 Statement re: Computation of Earnings per Share – Information contained in Note 4 to the Consolidated Financial Statements on page 13 of this Quarterly Report is incorporated herein by reference.

Exhibit  
31.1 Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer

Exhibit  
31.2 Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer

Exhibit  
32.1 Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer

Exhibit  
32.2 Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer

Exhibit  
101 Interactive Data File (XBRL)

Table of Contents

56

EXHIBIT INDEX

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

\*Furnished, not filed.

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

- (a) Incorporated by reference to Exhibit 3.i of Summit Financial Group, Inc.'s filing on Form 10-Q dated March 31, 2006.
- (b) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated September 30, 2009.
- (c) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated November 3, 2011.
- (d) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 10-Q dated March 31, 2007.

Table of Contents

57

---

SIGNATURES

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

SUMMIT FINANCIAL GROUP, INC.  
(registrant)

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

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

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

Date: November 2, 2018

Table of Contents

58