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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10 – Q

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

For the quarterly period ended March 31, 2011.
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from ___________ to __________.

Commission File Number 0-16587

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

West Virginia (State or other jurisdiction of incorporation or organization)	55-0672148 (IRS Employer Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

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

Yes o No o

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

Large accelerated filer o Accelerated filero

Non-accelerated filer o Smaller reporting companyþ

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

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

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

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

Dollars in thousands	March 31, 2011 (unaudited)	December 31, 2010 (*)	March 31, 2010 (unaudited)
ASSETS			
Cash and due from banks	$4,263	$4,652	$5,163
Interest bearing deposits with other banks	46,448	45,696	9,032
Securities available for sale	293,240	271,730	262,565
Other investments	21,956	22,941	24,008
Loans held for sale, net	402	343	429
Loans, net	979,387	995,319	1,112,526
Property held for sale	66,961	70,235	50,562
Premises and equipment, net	22,784	23,092	24,001
Accrued interest receivable	5,797	5,879	6,519
Intangible assets	8,914	9,002	9,265
Other assets	32,043	29,581	32,426
Total assets	$1,482,195	$1,478,470	$1,536,496
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	$86,735	$74,604	$71,100
Interest bearing	975,384	962,335	939,936
Total deposits	1,062,119	1,036,939	1,011,036
Short-term borrowings	1,879	1,582	27,456
Long-term borrowings	283,516	304,109	361,335
Subordinated debentures	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	8,964	9,630	9,746
Total liabilities	1,392,867	1,388,649	1,445,962
Commitments and Contingencies			
Shareholders' Equity			
Preferred stock and related surplus - authorized 250,000 shares;			
Series 2009, 8% Non-cumulative convertible preferred stock,			
par value $1.00; issued 3,710 shares	3,519	3,519	3,519
Common stock and related surplus - authorized 20,000,000 shares;			
$2.50 par value; issued and outstanding 2011 and			
2010 - 7,425,472 shares	24,515	24,508	24,508
Retained earnings	60,879	61,201	63,519
Accumulated other comprehensive income (loss)	415	593	(1,012)
Total shareholders' equity	89,328	89,821	90,534
Total liabilities and shareholders' equity	$1,482,195	$1,478,470	$1,536,496

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

See Notes to Consolidated Financial Statements

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

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

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

See Notes to Consolidated Financial Statements

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

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

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

See Notes to Consolidated Financial Statements

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

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

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

(Continued)

See Notes to Consolidated Financial Statements

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

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

See Notes to Consolidated Financial Statements

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

NOTE 1. BASIS OF PRESENTATION

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

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

The results of operations for the quarter ended March 31, 2011 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2010 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2010 and March 31, 2010, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures About Fair Value Measurements, requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements.
ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) company's should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy is required for us beginning January 1, 2011. The remaining disclosure requirements and clarifications made by ASU 2010-06 became effective for us on January 1, 2010. See Note 3 – Fair Value Measurements.

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

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

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

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

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

ASU No. 2010-28, Intangibles – Goodwill and Other (Topic 350) – When to Perform Step 2 of the goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples in paragraph 350-20-35-30, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This amendment was effective for us January 1, 2011 and had no impact on our financial statements.

NOTE 3. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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

Available-for-Sale Securities: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities.

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

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

Loans: We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, Accounting by Creditors for Impairment of a Loan. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At March 31, 2011, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with ASC Topic 310, impaired loans where an allowance is established based on the fair value of collateral requires classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When a current appraised value is not available and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

When a collateral-dependent loan is identified as impaired, management immediately begins the process of evaluating the estimated fair value of the underlying collateral to determine if a related specific allowance for loan losses or charge-off is necessary. Current appraisals are ordered once a loan is deemed impaired if the existing appraisal is more than twelve months old, or more frequently if there is known deterioration in value. For recently identified impaired loans, a current appraisal may not be available at the financial statement date. Until the current appraisal is obtained, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the loan’s underlying collateral since the date of the original appraisal. Such discounts are generally estimated based upon management’s knowledge of sales of similar collateral within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends. When a new appraisal is received (which generally are received within 3 months of a loan being identified as impaired), management then re-evaluates the fair value of the collateral and adjusts any specific allocated allowance for loan losses, as appropriate. In addition, management also assigns a discount of 7–10% for the estimated costs to sell the collateral. As of March 31, 2011, the appraised values of the underlying collateral for our collateral-dependent impaired loans which had a related specific allowance or prior charge-off was in excess of the total fair value by $12,107,000.

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

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

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

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

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

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

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

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

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

NOTE 5. SECURITIES

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

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

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

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

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

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

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

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

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

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

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

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

	Three Months Ended March 31, 2011
Dollars in thousands	Total
Beginning Balance	$ (3,910)
Additions for the credit component on debt securities in which other-than-temporary impairment was not previously recognized	(1,228)
Securities sold during the period	-
Ending Balance	$ (5,138)

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

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

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

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

	March 31, 2011					
	Less than 12 months		12 months or more		Total	
Dollars in thousands	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies and corporations	$ 16,953	$ (344)	$ 1,259	$ (14)	$ 18,212	$ (358)
Residential mortgage-backed securities:						
Government-sponsored agencies	41,034	(408)	-	-	41,034	(408)
Nongovernment-sponsored entities	1,304	(13)	9,829	(795)	11,133	(808)
State and political subdivisions	17,107	(1,172)	385	(5)	17,492	(1,177)
Corporate debt securities	965	(34)	-	-	965	(34)
Tax-exempt debt securities						
State and political subdivisions	20,170	(476)	1,161	(160)	21,331	(636)
Total temporarily impaired securities	97,533	(2,447)	12,634	(974)	110,167	(3,421)

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

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	December 31, 2010					
	Less than 12 months		12 months or more		Total	
Dollars in thousands	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						