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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PART II. OTHER INFORMATION

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	
Dollars in thousands, except per share amounts	March 31, 2011	March 31, 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

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

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

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

At March 31, 2011, we had $1.9 million in total unrealized losses related to residential mortgage-backed securities issued by nongovernment sponsored entities. We monitor the performance of the mortgages underlying these bonds. Although there has been some deterioration in their collateral performance, we primarily hold the senior tranches of each issue which provides protection against defaults. We attribute the unrealized loss on these mortgage-backed securities held largely to the current absence of liquidity in the markets for such securities. The mortgages in these asset pools have been made to borrowers with strong credit history and significant equity invested in their homes. Nonetheless, further weakening of economic fundamentals coupled with significant increases in unemployment and substantial deterioration in the value of high end residential properties could extend distress to this borrower population. This could increase default rates and put additional pressure on property values. Should these conditions occur, the value of these securities could decline further and result in the recognition of additional other-than-temporary impairment charges recognized in earnings.

NOTE 6. LOANS

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

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

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

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

Loans are summarized as follows:

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

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

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At March 31, 2011						
	Past Due					Recorded Investment > 90 days and Accruing
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	
Commercial	$ 906	$ 4	$ 2,142	$ 3,052	$ 89,175	$ -
Commercial real estate						
Owner-occupied	72	473	2,765	3,310	179,646	-
Non-owner occupied	1,916	53	1,421	3,390	237,214	-
Construction and development						
Land and land development	1,773	124	8,358	10,255	83,420	-
Construction	-	51	150	201	13,678	-
Residential mortgage						
Non-jumbo	5,229	1,184	3,889	10,302	223,006	-
Jumbo	-	-	927	927	60,951	-
Home equity	148	-	74	222	50,277	-
Consumer	406	77	143	626	22,342	-
Other	8	3	9	19	4,307	9
Total	$ 10,458	$ 1,969	$ 19,878	$ 32,304	$ 964,016	$ 9

At December 31, 2010						
	Past Due					Recorded Investment > 90 days and Accruing
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	
Commercial	$ 388	$ 307	$ 1,286	$ 1,981	$ 95,078	$ -
Commercial real estate						
Owner-occupied	364	-	1,348	1,712	185,386	-
Non-owner occupied	3,697	590	310	4,597	230,740	-
Construction and development						
	3,023	131	9,732	12,886	86,199	-

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

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At March 31, 2010						
	Past Due					Recorded Investment > 90 days and
Dollars in thousands	30-59 days	60-89 days	> 90 days	Total	Current	Accruing
Commercial	$ 155	$ 1,084	$ 469	$ 1,708	$ 119,550	$ -
Commercial real estate						
Owner-occupied	-	1,099	309	1,408	197,567	-
Non-owner occupied	2,203	6,701	33,000	41,904	214,516	-
Construction and development						
Land and land development	10,039	1,568	10,277	21,884	87,496	-
Construction	-	45	6,393	6,438	35,370	-
Residential mortgage						
Non-jumbo	5,214	1,072	2,765	9,051	243,243	-
Jumbo	927	655	627	2,209	64,772	-
Home equity	961	-	432	1,393	49,262	167
Consumer	293	132	190	615	26,687	3
Other	10	3	-	13	5,283	-
Total	$ 19,802	$ 12,359	$ 54,462	$ 86,623	$ 1,043,746	$ 170

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

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

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

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Impaired loans: Impaired loans include the following:

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

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

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

The tables below set forth information about our impaired loans.

Method Used to Measure Impairment of Impaired Loans
Dollars in thousands

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

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

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

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

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

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

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

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

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

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Pass: Loans graded as Pass are loans to borrowers of acceptable credit quality and risk. They are higher quality loans that do not fit any of the other categories described below.

OLEM (Special Mention): Commercial loans categorized as OLEM are potentially weak. The credit risk may be relatively minor yet represent a risk given certain specific circumstances. If the potential weaknesses are not monitored or mitigated, the asset may weaken or inadequately protect our position in the future.

Substandard: Commercial loans categorized as Substandard are inadequately protected by the borrower's ability to repay, equity, and/or the collateral pledged to secure the loan. These loans have identified weaknesses that could hinder normal repayment or collection of the debt. These loans are characterized by the distinct possibility that we will sustain some loss if the identified weaknesses are not mitigated.

Doubtful: Commercial loans categorized as Doubtful have all the weaknesses inherent in those loans classified as Substandard, with the added elements that the full collection of the loan is improbable and the possibility of loss is high.

Loss: Loans classified as loss are considered to be non-collectible and of such little value that their continuance as a bankable asset is not warranted. This does not mean that the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future.

Loan Risk Profile by Internal Risk Rating

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

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

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

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

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

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NOTE 7. ALLOWANCE FOR LOAN LOSSES

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

Dollars in thousands	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010	Year Ended December 31, 2010
Balance, beginning of period	$ 17,224	$ 17,000	$ 17,000
Losses:			
Commercial	1,827	23	601
Commercial real estate	-	393	9,239
Construction and development	-	2,790	7,937
Residential real estate	1,503	1,267	3,836
Consumer	55	84	279
Other	10	49	233
Total	3,395	4,606	22,125
Recoveries:			
Commercial	28	3	38
Commercial real estate	9	4	273
Construction and development	2	5	331
Residential real estate	13	31	164
Consumer	50	16	87
Other	2	40	106
Total	104	99	999
Net losses	3,291	4,507	21,126
Provision for loan losses	3,000	5,350	21,350
Balance, end of period	$ 16,933	$ 17,843	$ 17,224

Activity in the allowance for loan losses by loan class during the first three months of 2011 is as follows:

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	Construction & Land Development			Commercial Real Estate		Residential Real Estate					
Dollars in thousands	Land & Land Devlop-ment	Construc-tion	Commer-cial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity	Con-sumer	Other	Total
Allowance for loan losses											
Beginning balance	$7,901	$322	$323	$1,107	$2,941	$2,420	$1,315	$600	$263	$32	$17,224
Charge-offs	1,827	-	-	-	-	860	643	-	55	10	3,395
Recoveries	2	-	28	-	9	11	1	1	51	2	104
Provision	(173)	126	40	199	250	1,625	794	185	(57)	11	3,000
Ending balance	$5,903	$448	$391	$1,306	$3,200	$3,196	$1,467	$786	$201	$35	$16,933
Allowance related to:											
Loans individually evaluated for impairment	$1,161	$5	$13	$280	$470	$682	$447	$210	$-	$-	$3,268
Loans collectively evaluated for impairment	4,742	443	378	1,026	2,730	2,514	1,020	576	201	35	13,665
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Total	$5,903	$448	$391	$1,306	$3,200	$3,196	$1,467	$786	$201	$35	$16,933
Loans											
Loans individually evaluated for impairment	$22,130	$92	$1,436	$11,011	$4,985	$6,484	$15,401	$210	$-	$-	$61,749
Loans collectively											

evaluated for impairment	71,545	13,787	90,791	171,945	235,619	226,824	46,477	50,289	22,968	4,326	$934,571
Loans acquired with											
deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Total	$93,675	$13,879	$92,227	$182,956	$240,604	$233,308	$61,878	$50,499	$22,968	$4,326	$996,320

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NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

The following tables present our goodwill by reporting unit at March 31, 2011 and other intangible assets by reporting unit at March 31, 2011 and December 31, 2010.

Goodwill Activity			
Dollars in thousands	Community Banking	Insurance Services	Total
Balance, January 1, 2011	$ 1,488	$ 4,710	$ 6,198
Acquired goodwill, net	-	-	-
Balance, March 31, 2011	$ 1,488	$ 4,710	$ 6,198

Other Intangible Assets						
	March 31, 2011			December 31, 2010		
Dollars in thousands	Community Banking	Insurance Services	Total	Community Banking	Insurance Services	Total
Unidentifiable intangible assets						
Gross carrying amount	$ 2,267	$ -	$ 2,267	$ 2,267	$ -	$ 2,267
Less: accumulated amortization	1,801	-	1,801	1,763	-	1,763
Net carrying amount	$ 466	$ -	$ 466	$ 504	$ -	$ 504
Identifiable intangible assets						
Gross carrying amount	$ -	$ 3,000	$ 3,000	$ -	$ 3,000	$ 3,000
Less: accumulated amortization	-	750	750	-	700	700
Net carrying amount	$ -	$ 2,250	$ 2,250	$ -	$ 2,300	$ 2,300

We recorded amortization expense of approximately $88,000 for the three months ended March 31, 2011 relative to our other intangible assets. Annual amortization is expected to be approximately $351,000 for each of the years ending 2011 through 2013.

NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of March 31, 2011 and 2010 and December 31, 2010:

Dollars in thousands	March 31, 2011	December 31, 2010	March 31, 2010
Demand deposits, interest bearing	$ 153,283	$ 150,291	$ 148,657
Savings deposits	212,502	177,053	198,303
Retail time deposits	392,394	404,704	358,190
Wholesale deposits	217,205	230,287	234,786
Total	$ 975,384	$ 962,335	$ 939,936

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Brokered deposits represent certificates of deposit acquired through a third party. The following is a summary of the maturity distribution of all certificates of deposit in denominations of $100,000 or more as of March 31, 2011:

Dollars in thousands	Amount	Percent
Three months or less	$ 47,360	12.1 %
Three through six months	32,605	8.4 %
Six through twelve months	82,107	21.1 %
Over twelve months	227,762	58.4 %
Total	$ 389,834	100.0 %

A summary of the scheduled maturities for all time deposits as of March 31, 2011 is as follows:

Dollars in thousands	Amount
Nine month period ending December 31, 2011	$ 242,966
Year ending December 31, 2012	138,046
Year ending December 31, 2013	86,300
Year ending December 31, 2014	46,667
Year ending December 31, 2015	41,565
Thereafter	54,055
	$ 609,599

NOTE 10. BORROWED FUNDS

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

	Three Months Ended March 31, 2011		
Dollars in thousands	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at March 31	$ -	$ 925	$ 954
Average balance outstanding for the period	-	781	953
Maximum balance outstanding at any month end during period	-	925	953
Weighted average interest rate for the period	0.00 %	0.15 %	0.25 %
Weighted average interest rate for balances outstanding at March 31	0.00 %	0.15 %	0.25 %

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Summit Financial Group, Inc. and Subsidiaries
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	Year Ended December 31, 2010		
Dollars in thousands	Short-term FHLB Advances	Short-Term Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at December 31	$ -	$ 629	$ 953
Average balance outstanding for the period	13,724	1,084	1,364
Maximum balance outstanding at any month end during period	45,000	1,787	3,617
Weighted average interest rate for the period	0.42 %	0.34 %	1.39 %
Weighted average interest rate for balances outstanding at December 31	0.00 %	0.15 %	0.25 %

	Three Months Ended March 31, 2010		
Dollars in thousands	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at March 31	$ 25,000	$ 1,505	$ 951
Average balance outstanding for the period	41,187	1,158	2,621
Maximum balance outstanding at any month end during period	45,000	1,504	3,617
Weighted average interest rate for the period	0.37 %	0.41 %	2.62 %
Weighted average interest rate for balances outstanding at March 31	0.36 %	0.45 %	0.25 %

Long-term borrowings: Our long-term borrowings of $283,516,000, $304,109,000 and $361,335,000 at March 31, 2011, December 31, 2010, and March 31, 2010 respectively, consisted primarily of advances from the Federal Home Loan Bank ("FHLB") and structured reverse repurchase agreements with two unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

	Balance at March 31,	Balance at

Dollars in thousands	2011	2010	December 31, 2010
Long-term FHLB advances	$ 162,233	$ 238,698	$ 182,375
Long-term reverse repurchase agreements	110,000	110,000	110,000
Term loan	11,283	12,637	11,734
Total	$ 283,516	$ 361,335	$ 304,109

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

Our long term borrowings bear both fixed and variable rates and mature in varying amounts through the year 2019.

The average interest rate paid on long-term borrowings for the three month period ended March 31, 2011 was 4.15% compared to 4.91% for the first three months of 2010.

Subordinated debentures: We have subordinated debt totaling $16.8 million at March 31, 2011, December 31, 2010, and March 31, 2010. The subordinated debt qualifies as Tier 2 capital under Federal Reserve Board guidelines until the debt is within 5 years of its maturity; thereafter the amount qualifying as Tier 2 capital is reduced by 20 percent each year until maturity. During 2009, we issued $6.8 million in subordinated debt, of which $5 million was issued to an affiliate of a director of Summit. We also issued $1.0 million and $0.8 million to two unrelated parties. These three issuances bear an interest rate of 10 percent per annum, a term of 10 years, and are not prepayable by us within the first five years. During 2008, we issued $10 million of subordinated debt to an unrelated institution, which bears a variable interest rate of 1 month LIBOR plus 275 basis points, a term of 7.5 years, and is not prepayable by us within the first two and one half years.

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Subordinated debentures owed to unconsolidated subsidiary trusts: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the "capital securities") for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the "debentures"). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled $19,589,000 at March 31, 2011, December 31, 2010, and March 31, 2010.

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

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

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

Dollars in thousands		Long-term borrowings	Subordinated debentures	Subordinated debentures owed to unconsolidated subsidiary trusts
Year Ending December 31,	2011	$ 14,801	$ -	$ -
	2012	66,721	-	-
	2013	41,885	-	-
	2014	83,416	-	-
	2015	1,894	10,000	-
	Thereafter	74,799	6,800	19,589
		$ 283,516	$ 16,800	$ 19,589

NOTE 11. STOCK OPTION PLAN

The 2009 Officer Stock Option Plan was adopted by our shareholders in May 2009 and provides for the granting of stock options for up to 350,000 shares of common stock to our key officers. Each option granted under the Plan vests according to a schedule designated at the grant date and has a term of no more than 10 years following the vesting date. Also, the option price per share was not to be less than the fair market value of our common stock on the date of grant. The 2009 Officer Stock Option Plan, which expires in May 2019, replaces the 1998 Officer Stock Option Plan (collectively the “Plans”) that expired in May 2008.

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The fair value of our employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Because our employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options at the time of grant. There were no options granted during the first three months of 2011 or 2010.

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 three months of 2011 and 2010, our stock compensation expense and related deferred taxes were insignificant.

A summary of activity in our Plans during the first three months of 2011 and 2010 is as follows:

	For the Three Months Ended March 31,			
	2011		2010	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, January 1	317,180	$ 18.17	309,180	$ 18.54
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Outstanding, March 31	317,180	$ 18.17	309,180	$ 18.54

Other information regarding options outstanding and exercisable at March 31, 2011 is as follows:

	Options Outstanding				Options Exercisable		
Range of exercise price	# of shares	WAEP	Wted. Avg. Remaining Contractual Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of shares	WAEP	Aggregate Intrinsic Value (in thousands)
2.54 - $ $6.00	64,150	$ 5.15	2.85	$ 7	59,150	$ 5.37	$ -

6.01 - 10.00	33,680	9.20	5.34	-	31,280	9.43	-
10.01 - 17.50	2,300	17.43	2.92	-	2,300	17.43	-
17.51 - 20.00	51,300	17.79	5.75	-	51,100	17.79	-
20.01 - 25.93	165,750	25.15	4.53	-	165,750	25.15	-
	317,180	18.17		$ 7	309,580	18.51	$ -

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.

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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	March 31, 2011
Commitments to extend credit:	
Revolving home equity and credit card lines	$ 43,346
Construction loans	20,329
Other loans	34,488
Standby letters of credit	5,991
Total	$ 104,154

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

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

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

NOTE 13. REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). We believe, as of March 31, 2011, that we and each of our subsidiaries met all capital adequacy requirements to which they were subject.

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

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

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Dollars in thousands	Actual Amount	Actual Ratio	Minimum Required Regulatory Capital Amount	Minimum Required Regulatory Capital Ratio	To be Well Capitalized under Prompt Corrective Action Provisions Amount	To be Well Capitalized under Prompt Corrective Action Provisions Ratio
As of March 31, 2011						
Total Capital (to risk weighted assets)						
Summit	$125,201	11.7%	$85,453	8.0%	$106,817	10.0%
Summit Community	134,073	12.6%	85,437	8.0%	106,797	10.0%
Tier I Capital (to risk weighted assets)						
Summit	96,834	9.1%	42,727	4.0%	64,090	6.0%
Summit Community	120,506	11.3%	42,719	4.0%	64,078	6.0%
Tier I Capital (to average assets)						
Summit	96,834	6.6%	43,834	3.0%	73,057	5.0%
Summit Community	120,506	8.3%	43,796	3.0%	72,994	5.0%
As of December 31, 2010						
Total Capital (to risk weighted assets)						
Summit	129,610	11.8%	87,543	8.0%	109,428	10.0%
Summit Community	138,164	12.6%	87,558	8.0%	109,447	10.0%
Tier I Capital (to risk weighted assets)						
Summit	100,840	9.2%	43,771	4.0%	65,657	6.0%
Summit Community	124,192	11.3%	43,779	4.0%	65,668	6.0%
Tier I Capital (to average assets)						
Summit	100,840	6.9%	43,869	3.0%	73,116	5.0%
Summit Community	124,192	8.5%	43,851	3.0%	73,085	5.0%

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

§ The Bank achieving and maintaining a minimum Tier 1 leverage capital ratio of at least 8% and a total risk-based capital ratio of at least 11%;

§ The Bank providing 30 days prior notice of any declaration of intent to pay cash dividends to provide the Bank's regulatory authorities an opportunity to object;

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

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

Additional information regarding the MOU's is included in Part I. Item 1A – Risk Factors on our Form 10-K for the year ended December 31, 2010.

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

NOTE 14. SEGMENT INFORMATION

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

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

	Three Months Ended March 31, 2011				
In thousands	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	$10,553	$-	$(451)	$ -	$10,102
Provision for loan losses	3,000	-	-	-	3,000
Net interest income after provision for loan losses	7,553	-	(451)	-	7,102
Other income	(2,960)	1,237	1,359	(248)	(612)
Other expenses	5,738	1,027	459	(248)	6,976
Income (loss) before income taxes	(1,145)	210	449	-	(486)
Income tax expense (benefit)	(547)	90	219	-	(238)
Net income (loss)	(598)	120	230	-	(248)
Dividends on preferred shares	-	-	74	-	74
Net income (loss) applicable to common shares	$(598)	$120	$156	$ -	$(322)
Intersegment revenue (expense)	$(219)	$(29)	$248	$ -	$-
Average assets	$1,535,822	$6,680	$140,288	$ (210,555)	$1,472,235

	Three Months Ended March 31, 2010				
In thousands	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	$10,716	$-	$(484)	$ -	$10,232
Provision for loan losses	5,350	-	-	-	5,350
Net interest income after provision for loan losses	5,366	-	(484)	-	4,882
Other income	1,108	1,218	530	(340)	2,516
Other expenses	6,455	1,038	457	(340)	7,610
Income (loss) before income taxes	19	180	(411)	-	(212)

Income tax expense (benefit)	(231)	68	(169)	-	(332)
Net income (loss)	250	112	(242)	-	120
Dividends on preferred shares	-	-	74	-	74
Net income (loss) applicable to common shares	$250	$112	$(316)	$ -	$46
Intersegment revenue (expense)	$(312)	$(28)	$340	$ -	$-
Average assets	$1,572,527	$6,895	$143,544	$ (170,149)	$1,552,817

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Management's Discussion and Analysis of Financial Condition and
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INTRODUCTION

The following discussion and analysis focuses on significant changes in our financial condition and results of operations of Summit Financial Group, Inc. ("Company" or "Summit") and our operating segments, Summit Community Bank ("Summit Community"), and Summit Insurance Services, LLC for the periods indicated. See Note 14 of the accompanying consolidated financial statements for our segment information. This discussion and analysis should be read in conjunction with our 2010 audited financial statements and Annual Report on Form 10-K.

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

OVERVIEW

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

Interest earning assets declined by 6.65% for the first three months in 2011 compared to the same period of 2010 while our net interest earnings on a tax equivalent basis decreased only 1.34%. Our tax equivalent net interest margin increased 16 basis points. Historically high levels of nonaccrual loans continue to negatively impact our net interest earnings.

BUSINESS SEGMENT RESULTS

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

	Three Months Ended March 31,	
Dollars in thousands	2011	2010
Community banking	$ (598)	$ 250
Insurance	120	112
Parent and other	156	(316)
Consolidated net income (loss)	$ (322)	$ 46

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.

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Our most significant accounting policies are presented in the notes to the consolidated financial statements of our 2010 Annual Report on Form 10-K. These policies, along with the other disclosures presented in the financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

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

Allowance for Loan Losses: The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 8 to the consolidated financial statements of our 2010 Annual Report on Form 10-K describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of the financial review of the 2010 Annual Report on Form 10-K.

Goodwill: Goodwill is subject to a two-step impairment test by reporting unit at least annually to determine whether write-downs of the recorded balances are necessary. During the third quarter, we completed the required annual impairment test for 2010 for each of our reporting units, community banking and insurance services. The first step (Step 1) of impairment testing requires a comparison of each reporting unit's fair value to its carrying value to identify potential impairment. If the fair value equals or exceeds the related unit's carrying value, no write-down of recorded goodwill is necessary. If the fair value is less than the carrying value, an expense may be required on our books to write down the goodwill to the proper carrying value. The second step (Step 2) of impairment testing is necessary only if the reporting unit does not pass Step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination.

The fair value, carrying amount and allocated goodwill with regard to each of our reporting units as of September 30, 2010 (date of our most recent goodwill impairment test) were as follows:

(in thousands)	Community Banking	Insurance Services
Fair value	$ 159,510	$ 7,000
Carrying amount	126,755	6,651
Allocated goodwill	1,488	4,710

Neither of our reporting units failed Step 1 of the goodwill impairment tests conducted as of September 30, 2010. For purposes of these goodwill impairment tests, the following methodologies were utilized and key assumptions were made in determining the fair value of each reporting unit:

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

Insurance Services – We performed an internal valuation utilizing the income approach to determine the fair value of our Insurance Services reporting unit. This methodology consisted of discounting the expected future cash flows of this unit based upon a forecast of its operations considering long-term key business drivers such as anticipated commission revenue growth. The long term growth rate used in determining the terminal value was estimated at 0%, and a discount rate of 10% was applied to the Insurance Services unit's estimated future cash flows.

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

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

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

Deferred Income Tax Assets: At March 31, 2011, we had net deferred tax assets of $12.3 million. Based on our ability to offset the net deferred tax asset against taxable income in carryback years and expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at March 31, 2011. All available evidence, both positive and negative, was considered to determine whether, based on the weight of that evidence, impairment should be recognized. However, our forecast process includes judgmental and quantitative elements that may be subject to significant change. If our forecast of taxable income within the carryback/carryforward periods available under applicable law is not sufficient to cover the amount of net deferred tax assets, such assets may become impaired.

RESULTS OF OPERATIONS

Earnings Summary

Net income applicable to common shares for the three months ended March 31, 2011 declined to a loss of $322,000, or $0.04 per diluted shares as compared to income of $46,000 or $0.01 per diluted share for the same period of 2010. Earnings were negatively impacted for both periods by continued high provisions for loan losses due to our increased nonperforming loans. The provision for loan losses was $3.0 million and $5.35 million for the three months ended March 31, 2011 and 2010, respectively. Included in earnings for the three months ended March 31, 2011 was $1.6 million of realized securities gains, $3.4 million of charges resulting from the write down of a portion of our OREO properties to fair value and $1.2 million in other than temporary impairment charges on securities. Returns on average equity and assets for the first three months of 2011 were (1.14%) and (0.07%), respectively, compared with 0.20% and 0.01% for the same period of 2010.

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Net Interest Income

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

Our net interest income on a fully tax-equivalent basis totaled $10,367,000 for the three months ended March 31, 2011 compared to $10,508,000 for the same period of 2010, representing a decrease of $141,000 or 1.34%. This decrease is primarily the result of a decrease in loans, which was partially offset by a reduction in the cost of interest bearing liabilities (see Table II). Average interest earning assets decreased 6.65% from $1,446,523,000 during the first three months of 2010 to $1,350,338,000 for the first three months of 2011. Average interest bearing liabilities declined 6.42% from $1,383,018,000 at March 31, 2010 to $1,294,179,000 at March 31, 2011, at an average yield for the first three months of 2011 of 2.54% compared to 3.05% for the same period of 2010.

Our consolidated net interest margin increased to 3.11% for the three months ended March 31 2011, compared to 2.95% for the same period in 2010. The margin continues to be affected by elevated levels of nonaccruing loans. The present continued low interest rate environment has served to positively impact our net interest margin due to our liability sensitive balance sheet. For the three months ended March 31, 2011 compared to March 31, 2010, the yields on earning assets decreased 32 basis points, while the cost of our interest bearing funds decreased by 51 basis points. The decrease in the cost of interest bearing funds is primarily the result of our reducing or repricing over $100 million of our higher-rate long-term borrowings in late 2010.

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

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Table I - Average Balance Sheet and Net Interest Income Analysis
Dollars in thousands

	For the Three Months Ended					
	March 31, 2011			March 31, 2010		
	Average Balance	Earnings/ Expense	Yield/ Rate	Average Balance	Earnings/ Expense	Yield/ Rate
Interest earning assets						
Loans, net of unearned income (1)						
Taxable	$1,001,347	$15,083	6.11%	$1,145,202	$16,957	6.01%
Tax-exempt (2)	4,940	98	8.05%	6,685	126	7.64%
Securities						
Taxable	269,858	2,609	3.92%	252,500	3,138	5.04%
Tax-exempt (2)	37,827	658	7.05%	41,797	689	6.69%
Federal funds sold and interest bearing deposits with other banks	36,366	17	0.19%	339	11	13.16%
Total interest earning assets	1,350,338	18,465	5.55%	1,446,523	20,921	5.87%
Noninterest earning assets						
Cash & due from banks	4,036			15,645		
Premises and equipment	22,977			24,146		
Other assets	113,000			84,777		
Allowance for loan losses	(18,116)			(18,274)		
Total assets	$1,472,235			$1,552,817		
Interest bearing liabilities						
Interest bearing demand deposits	$148,263	$100	0.27%	$146,700	$173	0.48%
Savings deposits	197,638	501	1.03%	194,828	691	1.44%
Time deposits	623,318	4,142	2.69%	595,837	4,634	3.15%
Short-term borrowings	1,734	1	0.23%	44,966	57	0.51%
Long-term borrowings and capital trust securities	323,226	3,354	4.21%	400,687	4,858	4.92%
Total interest bearing liabilities	1,294,179	8,098	2.54%	1,383,018	10,413	3.05%

Noninterest bearing liabilities						
and shareholders' equity						
Demand deposits	78,023			70,569		
Other liabilities	9,634			7,872		
Total liabilities	1,381,836			1,461,459		
Shareholders' equity - preferred	3,519			3,519		
Shareholders' equity - common	86,880			87,839		
Total liabilities and						
shareholders' equity	$1,472,235			$1,552,817		
Net interest earnings		$10,367			$10,508	
Net yield on interest earning assets			3.11%			2.95%

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

(2) - Interest income on tax-exempt securities has been adjusted assuming an effective tax rate of 34% for all periods presented.
The tax equivalent adjustment resulted in an increase in interest income of $265,000 and $466,000 for the periods ended
March 31, 2011 and March 31 2010, respectively.

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

	For the Three Months Ended March 31, 2011 versus March 31, 2010 Increase (Decrease) Due to Change in:		
In thousands	Volume	Rate	Net
Interest earned on:			
Loans			
Taxable	$ (2,162)	$ 288	$ (1,874)
Tax-exempt	(34)	6	(28)
Securities			
Taxable	205	(734)	(529)
Tax-exempt	(67)	36	(31)
Federal funds sold and interest bearing deposits with other banks	27	(21)	6
Total interest earned on interest earning assets	(2,031)	(425)	(2,456)
Interest paid on:			
Interest bearing demand deposits	2	(75)	(73)
Savings deposits	10	(200)	(190)
Time deposits	207	(699)	(492)
Short-term borrowings	(36)	(20)	(56)
Long-term borrowings and capital trust securities	(861)	(643)	(1,504)
Total interest paid on interest bearing liabilities	(678)	(1,637)	(2,315)
Net interest income	$ (1,353)	$ 1,212	$ (141)

Noninterest Income

Total noninterest income decreased to a loss of $612,000 for the first three months of 2011, compared to income of $2,516,000 for the same period of 2010, with other-than-temporary impairment charges on securities and writedowns of OREO properties to their estimated fair value being the primary negative components. Further detail regarding noninterest income is reflected in the following table.

Noninterest Income

	For the Quarter Ended March 31,	
Dollars in thousands	2011	2010
Insurance commissions	$ 1,242	$ 1,209

Service fees		621		707
Realized securities gains (losses)		1,628		264
Other-than-temporary impairment of securities		(1,228)		(29)
Gain (loss) on sale of assets		71		12
Writedown of OREO		(3,443)		-
Other		497		353
Total	$	(612)	$	2,516

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Other-than-temporary impairment of securities: During the first three months of 2011, we recorded non-cash other-than temporary impairment charges of $1,228,000 related to certain residential mortgage-backed securities which we continue to own.

Writedown of OREO: During the first three months of 2011, we recorded $3,443,000 in charges to writedown certain OREO properties to estimated fair value as part of our normal, ongoing re-appraisal process. $2,719,000 of this writedown is attributable to one developer of three residential subdivisions.

Noninterest Expense

Total noninterest expense decreased approximately 8.3% for the three months ended March 31, 2011, as compared to the same period in 2010. While OREO expenses continue to increase due to higher levels of foreclosed properties, FDIC premiums are lower in 2011 due to our lower deposit base, and other expenses are down as a result of an anticipated refund of Virginia business franchise taxes paid or accrued for due to an allowable credit for OREO property taxes paid in Virginia being an allowable offset to taxable capital for business franchise tax calculation purposes. Table III below shows the breakdown of the changes.

Table III - Noninterest Expense

	For the Quarter Ended March 31,			
		Change		
Dollars in thousands	2011	$	%	2010
Salaries, commissions, and employee benefits	$ 3,842	$ 118	3.2 %	$ 3,724
Net occupancy expense	509	(12)	-2.3 %	521
Equipment expense	580	(49)	-7.8 %	629
Supplies	78	(31)	-28.4 %	109
Professional fees	196	(78)	-28.5 %	274
Amortization of intangibles	88	-	0.0 %	88
FDIC premiums	693	(132)	-16.0 %	825
OREO expense	434	202	87.1 %	232
Other	556	(652)	-54.0 %	1,208
Total	$ 6,976	$ (634)	-8.3 %	$ 7,610

Credit Experience

Due to continued recessionary economic conditions, borrowers have in many cases been unable to meet their current debt obligation due to a range of factors including declining property values and elevated unemployment levels. As a result, we have experienced higher delinquencies and nonperforming assets, particularly in our residential real estate loan portfolios and in commercial construction loans to residential real estate developers. It is not known when the housing market will stabilize. Management anticipates loan delinquencies will generally trend lower than those experienced over the past two years, and we anticipate that nonperforming assets will remain elevated in the near term.

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 $3,000,000 and $5,350,000 provisions for loan losses for the first three months of 2011 and 2010, respectively. This decline is a result of lower levels of impaired loans at March 31, 2011 compared to March 31, 2010. At March 31, 2010, the allowance for loan losses totaled $16,933,000 or 1.70% of loans, net of unearned income, compared to $17,224,000 or 1.70% of loans, net of unearned income, at December 31, 2010.

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As illustrated in Table IV below, our non-performing assets have decreased during the past 12 months.

Table IV - Summary of Non-Performing Assets

Dollars in thousands	March 31, 2011	March 31, 2010	December 31, 2010
Accruing loans past due 90 days or more	$ 9	$ 170	$ 1,442
Nonaccrual loans			
Commercial	2,186	511	1,318
Commercial real estate	5,284	33,907	2,686
Commercial construction and development	131	9,668	-
Residential construction and development	8,428	7,018	10,049
Residential real estate	6,343	4,053	6,075
Consumer	197	206	141
Total nonaccrual loans	22,569	55,363	20,269
Foreclosed properties			
Commercial	597	-	597
Commercial real estate	13,738	5,086	14,745
Commercial construction and development	16,918	4,814	17,021
Residential construction and development	32,002	36,447	34,377
Residential real estate	3,706	4,215	3,495
Consumer	-	-	-
Total foreclosed properties	66,961	50,562	70,235

Repossessed assets	262	291	289
Total nonperforming assets	$ 89,801	$ 106,386	$ 92,235
Total nonperforming loans as a percentage of total loans	2.26 %	4.90 %	2.14 %
Total nonperforming assets as a percentage of total assets	6.06 %	6.92 %	6.24 %

The following table presents a summary of our 30 to 89 days past due performing loans.

Loans Past Due 30-89 Days	For the Quarter Ended				
Dollars in thousands	3/31/2011	12/31/2010	9/30/2010	6/30/2010	3/31/2010
Commercial	$ 910	$ 695	$ 817	$ 516	$ 1,239
Commercial real estate	2,514	4,651	1,933	9,246	10,003
Construction and development	1,948	3,156	1,711	819	11,652
Residential real estate	6,561	20,120	7,050	10,846	8,829
Consumer	494	586	691	536	438
Total	$ 12,427	$ 29,208	$ 12,202	$ 21,963	$ 32,161

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

Significant Nonperforming Loan Relationships
March 31, 2011
In thousands

Location by Region	Underlying Collateral	Loan Origination Date	Loan Nonaccrual Date	Current Loan Balance	Method Used to Measure Impairment	Most Recent Appraised Value		Amount Allocated to Allowance for Loan Losses	Amount Previously Charged-off
Rockingham Co., VA & Hardy Co., WV	Residential subdivision & undeveloped acreage	Nov. 2007 & Oct. 2005	Mar. 2009 & Mar. 2011	$ 2,126	Collateral value	$ 2,493	(1)	$ 11	$ 904
Northern VA	Commercial building	Jan. 2009	Jun. 2010	$ 1,326	Collateral value	$ 1,265	(1)	$ 246	$ -
Jefferson Co., WV	Residential building lots, single familty residence & undeveloped acreage	Aug. 2006 & Dec. 2007	Oct. 2010	$ 1,082	Collateral value	$ 808	(1)	$ 355	$ 643
Rockingham Co., VA	Convenience store	Apr. 2004	Mar. 2011	$ 1,095	Collateral value	$ 2,766	(2)	$ -	$ -
Shenandoah Co., Spotsylvania Co., and Fauquier Co., VA	Single family rentals & residential lots	Mar. 2007 & May 2008	Jan. 2011 & Mar. 2011	$ 1,584	Collateral value	$ 2,118	(2)	$ -	$ -
Western MD and Florida	Residential development, undeveloped acreage, 2 residential condos, a single family residence and a residential building lot	Various 2003-2007	Jun. 2010	$ 4,552	Collateral value	$ 7,937	(1)	$ 320	$ 1,290

(1) - Values based upon recent external appraisal.
(2) - Values based upon appraisal obtained at loan origination. New appraisal has been ordered.

As a result of our internal loan review process, the ratio of internally criticized loans to total loans increased from 10.47% at December 31, 2010 to 10.83% at March 31, 2011. Our internal loan review process includes a watch list of loans that have been specifically identified through the use of various sources, including past due loan reports, previous internal and external loan evaluations, classified loans identified as part of regulatory agency loan reviews and reviews of new loans representative of current lending practices. Once this watch list is reviewed to ensure it is complete, we review the specific loans for collectability, performance and collateral protection. In addition, a grade is assigned to the individual loans utilizing internal grading criteria, which is somewhat similar to the criteria utilized by our subsidiary bank's primary regulatory agency. The decrease in the land development and construction category was primarily the result of foreclosures. Refer to the Asset Quality section of the financial review of the 2010 Annual Report on Form 10-K for further discussion of the processes related to internally classified loans.

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Internally Criticized Loans

In thousands	3/31/2011	12/31/2010	9/30/2010	6/30/2010	3/31/2010
Commerical	$ 6,605	$ 5,979	$ 7,272	$ 8,113	$ 7,342
Commercial real estate	38,487	36,395	35,401	45,971	63,079
Land development & construction	33,039	34,751	27,544	27,216	30,145
Residential real estate	29,689	29,045	27,788	24,714	22,705
Consumer	38	40	-	-	-
Total	$ 107,858	$ 106,210	$ 98,005	$ 106,014	$ 123,271

Included in the above table of internally criticized loans are approximately $5.6 million of performing loans which we have identified as potential problem loans at March 31, 2011. These loans are performing at March 31, 2011, but known information about possible credit problems of the related borrowers causes management to have concerns as to the ability of such borrowers to comply with the current loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, or require increased allowance coverage and provision for loan losses.

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

Specific Reserve for Loans Individually Evaluated

First, we identify loan relationships having aggregate balances in excess of $500,000 and that may also have credit weaknesses. Such loan relationships are identified primarily through our analysis of internal loan evaluations, past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – that is, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of our impaired loans are and historically have been collateral dependent, meaning repayment of the loan is expected to be provided solely from the sale of the loan's underlying collateral. For such loans, we measure impairment based on the fair value of the loan's collateral, which is generally determined utilizing current appraisals. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell. Our policy is to re-evaluate the fair value of collateral dependent loans at least every twelve months unless there is a known deterioration in the collateral's value, in which case a new appraisal is obtained.

Quantitative Reserve for Loans Collectively Evaluated

Second, we stratify the loan portfolio into the following ten loan pools: land and land development, construction, commercial, commercial real estate -- owner-occupied, commercial real estate -- non-owner occupied, conventional residential mortgage, jumbo residential mortgage, home equity, consumer, and other. Loans within each pool are then further segmented between larger-balance loan relationships exceeding $2 million loans which were individually evaluated for impairment and not deemed to be impaired and smaller-balance homogenous loans.

Quantitative reserves relative to each loan pool are established by assigning an allocation equaling 100% of the respective pool's average 12 month historical net loan charge-off rate (determined based upon the most recent twelve quarters) is applied to the aggregate recorded investment in the smaller-balance homogenous pool of loans.

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Qualitative Reserve for Loans Collectively Evaluated

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

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

In analyzing the relationship between the allowance for loan losses, net loan charge-offs and nonperforming loans, it is helpful to understand the process of how loans are treated as they deteriorate over time. Reserves for loans are established at origination through the quantitative and qualitative reserve process discussed above. If the quality of a loan which is reviewed as part of our normal internal loan review procedures deteriorates to a point causing us to deem the loan impaired, the loan is then evaluated for specific reserves under FAS 114, and a reserve, if necessary, is assigned.

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

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

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

Substantially all of our nonperforming loans are secured by real estate. The substantial majority of these loans were underwritten in accordance with our loan-to-value policy guidelines which range from 70-85% at the time of origination. Although property values have deteriorated across our market areas, the fair values of the underlying collateral value remains in excess of the recorded investment in many of our nonperforming loans, and therefore, no specific reserve allocation is required; as of March 31, 2011, approximately 75% of our impaired loans required no reserves or have been charged down to their fair value. Accordingly, our allowance for loan losses has not increased proportionately as our nonperforming loans have increased. The allowance for loan loss will, however, increase as a result of an increase in net loan charge-offs due to the incremental higher historical net charge-off rate applied to the loans which are collectively evaluated for impairment.

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At March 31, 2011, December 31, 2010, and March 31, 2010, our allowance for loan losses totaled $16,933,000, or 1.70% of total loans, $17,224,000, or 1.70% of total loans and $17,843,000, or 1.58% of total loans, respectively, and is considered adequate to cover inherent losses in our loan portfolio.

At March 31, 2011, December 31, 2010, and March 31, 2010, we had approximately $66,961,000, $70,235,000 and $50,562,000, respectively, in other real estate owned which was obtained as the result of foreclosure proceedings. Although foreclosed property is recorded at fair value less estimated costs to sell, the prices ultimately realized upon their sale may or may not result in us recognizing loss.

FINANCIAL CONDITION

Our total assets were $1,482,195,000 at March 31, 2011, compared to $1,478,470,000 at December 31, 2010, representing a 0.25% increase. Table V below serves to illustrate significant changes in our financial position between December 31, 2010 and March 31, 2011.

Table V - Summary of Significant Changes in Financial Position

Dollars in thousands	Balance December 31, 2010	Increase (Decrease) Amount	Percentage	Balance March 31, 2011
Assets				
Securities available for sale	$ 271,730	21,510	7.9 %	$ 293,240
Loans, net of unearned interest	1,012,543	(16,223)	-1.6 %	996,320
Liabilities				
Deposits	$ 1,036,939	$ 25,180	2.4 %	$ 1,062,119
Short-term borrowings	1,582	297	18.8 %	1,879
Long-term borrowings	304,109	(20,593)	-6.8 %	283,516
Subordinated debentures	16,800	-	0.0 %	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	-	0.0 %	19,589

Loans decreased 1.6% and securities increased 7.9% during the first three months of 2011. We have restricted our growth in order to improve our capital ratios.

Deposits increased approximately $25.2 million during the first three months of 2011, primarily in retail deposits.

The decrease in long term borrowings is primarily attributable to maturities and repayments of long-term FHLB advances during the first three months of 2011 funded by increased deposits.

Refer to Notes 6, 7, 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 March 31, 2010 and December 31, 2010.

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"), which totaled approximately $393.3 million or 26.5% of total consolidated assets at March 31, 2011.

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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 $448 million. As of March 31, 2011 and December 31, 2010, these advances totaled approximately $162 million and $182 million, respectively. At March 31, 2011, we had additional borrowing capacity of $218 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 March 31, 2011 was approximately $63 million, which is secured by a pledge of our consumer and commercial and industrial loan portfolios. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises.

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

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

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

- Would have limited amounts of maturing brokered deposits to replace in the short-term, as we have limited our brokered deposits maturing in any one quarter to no more than $50 million.
- Presently has $420 million in available sources of liquid funds which could be drawn upon to fund maturing brokered deposits until Summit Community had restored its capital to well capitalized status.
- Would first seek to restore its capital to well capitalized status through capital contributions from Summit, its parent holding company. Summit has present cash reserves in excess of $4 million available for capital infusion into Summit Community.
- Would generally have no more than $100 million in brokered deposits maturing in any one year time frame, which is well within its presently available sources of liquid funds, if in the event Summit does not have the capital resources to restore Summit Community's capital to well capitalized status. One year would give Summit Community ample time to raise alternative funds either through retail deposits or the sale of assets, and obtain capital resources to restore it to well capitalized status.

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

- Would severely curtail lending and other growth activities until such time as access to this line could be restored, thus eliminating the need for net new advances, and
- Would still have available current liquid funding sources secured by unemcumbered loans and securities totaling $227 million aside from its FHLB line, which would result in a funding source of approximately $175 million.

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

- Presently has $420 million in available sources of liquid funds which could be drawn upon immediately to fund any "net run off" of deposits from this activity.
- Would severely curtail lending and other growth activities so as to preserve the availability of as much contingency funds as possible.
- Would begin offering its own competitive deposit program when deemed prudent so as to restore the retail deposits lost to the competition.

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

One of our continuous goals is maintenance of a strong capital position. Through management of our capital resources, we seek to provide an attractive financial return to our shareholders while retaining sufficient capital to support future growth. Shareholders' equity at March 31, 2011 totaled $89,328,000 compared to $89,821,000 at December 31, 2010.

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

- Summit Community achieving and maintaining a minimum Tier 1 leverage capital ratio of at least 8% and a total risk-based capital ratio of at least 11%;

- Summit Community providing 30 days prior notice of any declaration of intent to pay cash dividends to provide the Bank's regulatory authorities an opportunity to object;

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

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

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

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

CONTRACTUAL CASH OBLIGATIONS

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at March 31, 2011.

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Dollars in thousands	Long Term Debt	Capital Trust Securities	Operating Leases
2011	$ 14,801	$ -	$ 137
2012	66,720	-	151
2013	41,885	-	138
2014	83,416	-	125
2015	11,894	-	21
Thereafter	81,600	19,589	-
Total	$ 300,316	$ 19,589	$ 572

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 March 31, 2011 are presented in the following table.

Dollars in thousands	March 31, 2011
Commitments to extend credit:	
Revolving home equity and credit card lines	$ 43,346
Construction loans	20,329
Other loans	34,488
Standby letters of credit	5,991
Total	$ 104,154

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MARKET RISK MANAGEMENT

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

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position is liability sensitive. The nature of our lending and funding activities tends to drive our interest rate risk position to being liability sensitive. That is, absent any changes in the volumes of our interest earning assets or interest bearing liabilities, liabilities are likely to reprice faster than assets, resulting in a decrease in net income in a rising rate environment. Net income would increase in a falling interest rate environment. Net income is also subject to changes in the shape of the yield curve. In general, a flattening yield curve would result in a decline in our earnings due to the compression of earning asset yields and funding rates, while a steepening would result in increased earnings as margins widen.

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

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of March 31, 2011. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable thereafter for the up and down 100 and the up 200 scenarios, and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above and are well within our ALCO policy limit, which is a 10% reduction in net interest income over the ensuing twelve month period.

Change in Interest Rates	Estimated % Change in Net Interest Income Over:

(basis points)	0-12 Months	13-24 Months
Down 100 (1)	1.53%	8.16%
Up 100 (1)	-1.90%	2.42%
Up 200 (1)	-3.97%	-0.92%
Up 400 (2)	-3.94%	-2.99%

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

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CONTROLS AND PROCEDURES

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of March 31, 2011, 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 March 31, 2011 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010.

SIGNATURES

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

SUMMIT FINANCIAL GROUP, INC.
(registrant)

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

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

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

Date: May 2 , 2011