SUMMIT FINANCIAL GROUP INC
Form 10-K
March 17, 2008

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

FORM 10-K

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

For the fiscal year ended December 31, 2007

Commission File Number 0-16587

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

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

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

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

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

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K [§229.405 of this chapter] is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. o

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

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant at June 30, 2007, was approximately $102,564,000. The number of shares of the Registrant's Common Stock outstanding on March 3, 2008, was 7,408,941. (Registrant has assumed that all of its executive officers and directors are affiliates. Such assumption shall not be deemed to be conclusive for any other purpose.)

Documents Incorporated by Reference

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

Document	Part of Form 10-K into which document is incorporated
Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 15, 2008	Part III - Items 10, 11, 12, 13, and 14

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FORWARD LOOKING INFORMATION

This filing contains certain forward looking statements (as defined in the Private Securities Litigation Act of 1995), which reflect our beliefs and expectations based on information currently available. These forward looking statements are inherently subject to significant risks and uncertainties, including changes in general economic and financial market conditions, our ability to effectively carry out our business plans and changes in regulatory or legislative requirements. Other factors that could cause or contribute to such differences are changes in competitive conditions and continuing consolidation in the financial services industry. Although we believe the expectations reflected in such forward looking statements are reasonable, actual results may differ materially.

PART I.

Item 1. Business

General

Summit Financial Group, Inc. (“Company” or “Summit”) is a $1.4 billion financial holding company headquartered in Moorefield, West Virginia. We provide commercial and retail banking services primarily in the Eastern Panhandle and South Central regions of West Virginia and the Northern region of Virginia. We provide these services through our community bank subsidiary: Summit Community Bank (“Summit Community”). We also operate Summit Insurance Services, LLC in Moorefield, West Virginia and Leesburg, Virginia.

Community Banking

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

In order to compete with other financial service providers, we principally rely upon personal relationships established by our officers, directors and employees with our customers, and specialized services tailored to meet our customers’ needs. We and our Bank Subsidiary have maintained a strong community orientation by, among other things, supporting the active participation of staff members in local charitable, civic, school, religious and community development activities. We also have a marketing program that primarily utilizes local radio and newspapers to advertise.

Our primary lending focus is providing commercial loans to local businesses with annual sales ranging from $300,000 to $30 million and providing owner-occupied real estate loans to individuals. Typically, our customers have financing requirements between $50,000 and $1,000,000. We generally do not seek loans of more than $5 million, but will consider larger lending relationships which involve exceptional levels of credit quality. Under our commercial banking strategy, we focus on offering a broad line of financial products and services to small and medium-sized businesses through full service banking offices. Summit Community Bank has senior management with extensive lending experience. These managers exercise substantial authority over credit and pricing decisions, subject to loan committee approval for larger credits. This decentralized management approach, coupled with continuity of service by the same staff members, enables the Bank Subsidiaries to develop long-term customer relationships, maintain high quality service and respond quickly to customer needs. We believe that our emphasis on local relationship banking, together with a conservative approach to lending, are important factors in our success and growth.

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

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Supervision and Regulation

General

We, as a financial holding company, are subject to the restrictions of the Bank Holding Company Act of 1956, as amended ("BHCA"), and are registered pursuant to its provisions. As a registered financial holding company, we are subject to the reporting requirements of the Federal Reserve Board of Governors ("FRB"), and are subject to examination by the FRB.

As a financial holding company doing business in West Virginia, we are also subject to regulation by the West Virginia Board of Banking and Financial Institutions and must submit annual reports to the West Virginia Division of Banking.

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

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

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

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

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

Permitted Non-banking Activities

The FRB permits, within prescribed limits, financial holding companies to engage in non-banking activities closely related to banking or to managing or controlling banks. Such activities are not limited to the state of West Virginia. Some examples of non-banking activities which presently may be performed by a financial holding company are: making or acquiring, for its own account or the account of others, loans and other extensions of credit; operating as an industrial bank, or industrial loan company, in the manner authorized by state law; servicing loans and other extensions of credit; performing or carrying on any one or more of the functions or activities that may be performed or carried on by a trust company in the manner authorized by federal or state law; acting as an investment or financial advisor; leasing real or personal property; making equity or debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and the development of low income areas; providing bookkeeping services or financially oriented data processing services for the holding company and its subsidiaries; acting as an insurance agent or a broker; acting as an underwriter for credit life insurance which is directly related to extensions of credit by the financial holding company system; providing courier services for certain financial documents; providing management consulting advice to nonaffiliated banks; selling retail money orders having a face value of not more than $1,000, traveler's checks and U.S. savings bonds; performing appraisals of real estate; arranging commercial real estate equity financing under certain limited circumstances; providing securities brokerage services related to securities credit activities; underwriting and dealing in government obligations and money market instruments; providing foreign exchange advisory and transactional services; and acting under certain circumstances, as futures commission merchant for nonaffiliated persons in the execution and clearance on major commodity exchanges of futures contracts and options.

Credit and Monetary Policies and Related Matters

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

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

In 1989, the United States Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA"). Under FIRREA depository institutions insured by the FDIC may now be liable for any losses incurred by, or reasonably expected to be incurred by, the FDIC after August 9, 1989, in connection with (i) the default of a commonly controlled FDIC-insured depository institution, or (ii) any assistance provided by the FDIC to commonly controlled FDIC-insured depository institution in danger of default. "Default" is defined generally as the appointment of a conservator or receiver and "in danger of default" is defined generally as the existence of certain conditions indicating that a "default" is likely to occur in the absence of regulatory assistance. Accordingly, in the event that any insured bank or subsidiary of Summit causes a loss to the FDIC, other bank subsidiaries of Summit could be liable to the FDIC for the amount of such loss.

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

Capital Requirements

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

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

Financial holding companies are required to maintain a risk-based capital ratio of 8%, of which at least 4% must be Tier 1 capital. The appropriate regulatory authority may set higher capital requirements when an institution's particular circumstances warrant. For purposes of the leverage ratio, the numerator is defined as Tier 1 capital and the denominator is defined as adjusted total assets (as specified in the guidelines). The guidelines provide for a minimum leverage ratio of 3% for financial holding companies that meet certain specified criteria, including excellent asset quality, high liquidity, low interest rate exposure and the highest regulatory rating. Financial holding companies not meeting these criteria are required to maintain a leverage ratio which exceeds 3% by a cushion of at least 1 to 2 percent.

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

On August 2, 1995, the FRB and other banking agencies issued their final rule to implement the portion of Section 305 of FDICIA that requires the banking agencies to revise their risk-based capital standards to ensure that those standards take adequate account of interest rate risk. This final rule amends the capital standards to specify that the banking agencies will include, in their evaluations of a bank’s capital adequacy, an assessment of the exposure to declines in the economic value of the bank’s capital due to changes in interest rates.

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

Our regulatory capital ratios and the Bank Subsidiary’s capital ratios as of year end 2007 are set forth in the table in Note 16 of the notes to the consolidated financial statements on page 59.

Federal Deposit Insurance Corporation Improvement Act of 1991

In December, 1991, Congress enacted the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), which substantially revised the bank regulatory and funding provisions of the Federal Deposit Insurance Corporation Act and made revisions to several other banking statues.

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

By regulation, an institution is "well-capitalized" if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater and a Tier 1 leverage ratio of 5% or greater and is not subject to a regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure. Summit Community was a "well capitalized" institution as of December 31, 2007. As well-capitalized institutions, they are permitted to engage in a wider range of banking activities, including among other things, the accepting of "brokered deposits," and the offering of interest rates on deposits higher than the prevailing rate in their respective markets.

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

Reigle-Neal Interstate Banking Bill

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

Community Reinvestment Act

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

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

Graham-Leach-Bliley Act of 1999

The enactment of the Graham-Leach-Bliley Act of 1999 (the “GLB Act”) represents a pivotal point in the history of the financial services industry. The GLB Act swept away large parts of a regulatory framework that had its origins in the Depression Era of the 1930s. Effective March 11, 2000, new opportunities were available for banks, other depository institutions, insurance companies and securities firms to enter into combinations that permit a single financial services organization to offer customers a more complete array of financial products and services. The GLB Act provides a new regulatory framework through the financial holding company, which have as its “umbrella regulator” the

FRB. Functional regulation of the financial holding company's separately regulated subsidiaries are conducted by their primary functional regulators. The GLB Act makes a CRA rating of satisfactory or above necessary for insured depository institutions and their financial holding companies to engage in new financial activities. The GLB Act also provides a Federal right to privacy of non-public personal information of individual customers.

Deposit Acquisition Limitation

Under West Virginia banking law, an acquisition or merger is not permitted if the resulting depository institution or its holding company, including its affiliated depository institutions, would assume additional deposits to cause it to control deposits in the State of West Virginia in excess of twenty five percent (25%) of such total amount of all deposits held by insured depository institutions in West Virginia. This limitation may be waived by the Commissioner of Banking by showing good cause.

Consumer Laws and Regulations

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

Sarbanes-Oxley Act of 2002

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

Competition

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

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

Employees

At March 1, 2008, we employed 238 full-time equivalent employees.

Available Information

Our internet website address is www.summitfgi.com, and our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K, and amendments to such filed reports with the Securities and Exchange

Commission ("SEC") are accessible through this website free of charge as soon as reasonably practicable after we electronically file such reports with the SEC. The information on our website is not, and shall not be deemed to be, a part of this report or incorporated into any other filing with the Securities and Exchange Commission.

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

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Statistical Information

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

Item 1A. Risk Factors

Investments in Summit Financial Group, Inc. common stock involve risk as discussed below.

Market Price Fluctuations

The market price of our stock may fluctuate significantly in response to several factors, including:

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

Government Regulation

Future governmental regulation and legislation could limit growth. We and our subsidiaries are subject to extensive state and federal regulation, supervision, and legislation that govern nearly every aspect of our operations. Changes to these laws could affect our ability to deliver or expand our services and diminish the value of our business.

Interest Rate Risk

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

Credit Risk

We take credit risk by virtue of making loans, purchasing non-governmental securities, extending loan commitments and letters of credit, and being counterparties to off-balance sheet financial instruments such as interest rate derivatives. We manage the credit risk through a program of consistent underwriting standards, the review of certain credit decisions, and an on-going process of assessment of the quality of the credit already extended. Our credit administration function uses risk management techniques to ensure that loans adhere to corporate policy and problem loans are promptly identified. These procedures provide us with the information necessary to implement policy adjustments where necessary, and to take proactive corrective actions.

Competition

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

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Growth and Capital

We may not be able to maintain and manage our growth, which may adversely affect our results of operations and financial condition. We have had significant growth during the past five years, and we plan to continue to grow and expand. Our ability to continue to grow depends on our ability to open new branch offices, attract deposits to those locations, and identify loan and investment opportunities. Our ability to manage growth successfully also will depend on whether we can maintain capital levels adequate to support our growth and maintain cost controls and asset quality. It is possible that we may need to raise additional capital to support future growth. We cannot make any assurance that additional capital would be available on terms satisfactory to us at all. This could force us to limit our growth strategy. If we are unable to sustain our growth, our earnings could be adversely affected. If we grow too quickly, however, and are not able to control costs and maintain asset quality, rapid growth also could adversely affect our financial performance.

Key Personnel

Our success is dependent upon the continued service and skills of our executive officers and senior management. If we lose the services of these key personnel, it could have a negative impact on our business because of their skills, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Other

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

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

Our principal executive office is located at 300 North Main Street, Moorefield, West Virginia in a building that we own. The Bank Subsidiary's headquarters and branch locations occupy offices which are either owned or operated under long-term lease arrangements. At December 31, 2007, our Bank Subsidiary operated 15 banking offices. Summit Insurance Services, LLC operates out of the Moorefield, West Virginia office of Summit Community Bank, and also leases 2 locations in Leesburg, Virginia.

	Number of Offices		
Office Location	Owned	Leased	Total
Summit Community Bank			
Moorefield, West Virginia	1	-	1
Mathias, West Virginia	1	-	1
Franklin, West Virginia	1	-	1
Petersburg, West Virginia	1	-	1
Charleston, West Virginia	2	-	2
Rainelle, West Virginia	1	-	1
Rupert, West Virginia	1	-	1
Winchester, Virginia	1	1	2

Leesburg, Virginia	-	1	1
Harrisonburg, Virginia	-	2	2
Warrenton, Virginia	-	1	1
Martinsburg, West Virginia	1	-	1
Summit Insurance Services, LLC			
Leesburg, Virginia	-	2	2

We believe that the premises occupied by us and our subsidiaries generally are well-located and suitably equipped to serve as financial services facilities. See Notes 8 and 9 of our consolidated financial statements on pages 50 and 51.

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Item 3. Legal Proceedings

Information required by this item is set forth under the caption "Litigation" in Note 15 of our consolidated financial statements on page 58.

Item 4. Submission of Matters to a Vote of Shareholders

No matters were submitted during the fourth quarter of 2007 to a vote of Company shareholders.

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PART II.

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

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

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2007				
Dividends paid	$ -	$ 0.17	$ -	$ 0.17
High Bid	21.56	21.20	19.85	18.96
Low Bid	19.45	19.65	18.28	13.56
2006				
Dividends paid	$ -	$ 0.16	$ -	$ 0.16
High Bid	25.09	24.52	24.18	20.16
Low Bid	19.90	19.10	17.95	17.50

Dividends on Summit’s common stock are paid on the 15th day of June and December. The record date is the 1st day of each respective month. For a discussion of restrictions on dividends, see Note 16 of the notes to the accompanying consolidated financial statements.

As of March 1, 2008, there were approximately 1,304 shareholders of record of Summit’s common stock.

Purchases of Summit Equity Securities:

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

In August 2006, the Board of Directors authorized the open market repurchase of up to 225,000 shares (approximately 3%) of the issued and outstanding shares of Summit’s common stock (“August 2006 Repurchase Plan”). The timing and quantity of purchases under this stock repurchase plan will be at the discretion of management, and the plan may be discontinued, or suspended and reinitiated, at any time.

The following table sets forth certain information regarding Summit’s purchase of its common stock under the Repurchase Plan and under Summit’s ESOP for the quarter ended December 31, 2007.

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (b)
October 1, 2007 - October 31, 2007	725	$ 18.00	-	170,375
November 1, 2007 - November 30, 2007	6,000	17.71	5,000	165,375
December 1, 2007 - December 31, 2007	8,700	14.71	-	165,375

(a) Includes shares repurchased under the August 2006 Repurchase Plan and shares repurchased under the Employee Stock Ownership Plan.

(b) Shares available to be repurchased under the August 2006 Repurchase Plan.

Performance Graph:

Set forth below is a line graph comparing the cumulative total return of Summit's Common Stock assuming reinvestment of dividends, with that of the NASDAQ Composite Index ("NASDAQ Composite") and a peer group for the five-year period ending December 31, 2007. The "Summit Peer Group" consists of publicly-traded bank holding companies headquartered in West Virginia and Virginia having total assets between $500 million and $2 billion.

The cumulative total shareholder return assumes a $100 investment on December 31, 2002 in the common stock of Summit and each index and the cumulative return is measured as of each subsequent fiscal year-end. There is no assurance that Summit's common stock performance will continue in the future with the same or similar trends as depicted in the graph.

The Stock Performance Graph and related information shall not be deemed "soliciting material" or to be "filed" with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that Summit specifically incorporates it by reference into such filing.

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Item 6. Selected Financial Data

The following consolidated selected financial data is derived from our audited financial statements as of and for the five years ended December 31, 2007. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes contained elsewhere in this report.

	For the Year Ended (unless otherwise noted)				
Dollars in thousands, except per share amounts	2007	2006	2005	2004	2003
Summary of Operations					
Interest income	$ 91,384	$ 80,278	$ 56,653	$ 45,041	$ 41,154
Interest expense	52,317	44,379	26,502	18,663	17,827
Net interest income	39,067	35,899	30,151	26,378	23,327
Provision for loan losses	2,055	1,845	1,295	1,050	915
Net interest income after provision for loan losses	37,012	34,054	28,856	25,328	22,412
Noninterest income	7,357	3,634	1,605	3,263	3,275
Noninterest expense	25,098	21,610	19,264	16,919	14,218
Income before income taxes	19,271	16,078	11,197	11,672	11,469
Income tax expense	5,734	5,018	3,033	3,348	3,414
Income from continuing operations	13,537	11,060	8,164	8,324	8,055
Discontinued operations					
Exit costs and impairment of long-lived assets	(312)	(2,480)	-	-	-
Operating income (loss)	(10,347)	(1,750)	3,862	2,913	(44)
Income (loss) from discontinued operations before tax	(10,659)	(4,230)	3,862	2,913	(44)
Income tax expense (benefit)	(3,578)	(1,427)	1,339	1,004	(15)
Income (loss) from discontinued operations	(7,081)	(2,803)	2,523	1,909	(29)
Net income	$ 6,456	$ 8,257	$ 10,687	$ 10,233	$ 8,026
Balance Sheet Data (at year end)					
Assets	$ 1,435,536	$ 1,235,519	$ 1,110,214	$ 889,830	$ 791,577
Securities	300,066	247,874	223,772	211,362	235,409
Loans	1,052,489	916,045	793,452	602,728	498,340
Deposits	828,687	888,687	673,887	524,596	511,801
Short-term borrowings	172,055	60,428	182,028	120,629	49,714
Long-term borrowings and subordinated debentures	335,327	195,699	172,295	173,101	168,549
Shareholders' equity	89,420	78,752	72,691	65,150	57,005
Per Share Data					
Earnings per share from continuing operations					
Basic earnings	$ 1.87	$ 1.55	$ 1.15	$ 1.18	$ 1.14

Diluted earnings	1.85	1.54	1.13	1.17	1.14
Earnings per share from discontinued operations					
Basic earnings	(0.98)	(0.39)	0.35	0.27	-
Diluted earnings	(0.97)	(0.39)	0.35	0.27	-
Earnings per share					
Basic earnings	0.89	1.16	1.51	1.46	1.14
Diluted earnings	0.88	1.15	1.48	1.44	1.14
Shareholders' equity (at year end)	12.07	11.12	10.20	9.25	8.12
Cash dividends	0.34	0.32	0.30	0.26	0.215
Performance Ratios					
Return on average equity	7.34%	10.44%	15.09%	16.60%	14.69%
Return on average assets	0.50%	0.70%	1.10%	1.22%	1.11%
Dividend payout	38.1%	27.6%	20.0%	17.9%	18.8%
Equity to assets	6.2%	6.4%	6.5%	7.3%	7.2%

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

FORWARD LOOKING STATEMENTS

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

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

DESCRIPTION OF BUSINESS

We are a $1.4 billion community-based financial services company providing a full range of banking and other financial services to individuals and businesses through our two operating segments: community banking and insurance. Our community bank, Summit Community Bank, has a total of 15 banking offices located in West Virginia and Virginia. In addition, we also operate an insurance agency, Summit Insurance Services, LLC with an office in Moorefield, West Virginia which offers both commercial and personal lines of insurance. During 2007, we acquired the Kelly Agencies, two Leesburg, Virginia insurance agencies primarily specializing in group health, life and disability benefit plans and merged them into Summit Insurance Services, LLC. Although our business operates as two separate segments, the insurance segment is not a reportable segment as it is immaterial, and thus our financial information is presented on an aggregated basis. Summit Financial Group, Inc. employs approximately 250 full time equivalent employees.

OVERVIEW

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

Key Items in 2007

- We achieved record earnings from continuing operations in 2007. Income from continuing operations totaled $13,537,000, or $1.85 per diluted share, an increase of 20.1%.

- We settled the pending litigation related to our previous mortgage banking segment, which resulted in an after-tax charge included in discontinued operations of $5.8 million. This allows us to now fully focus on our core banking business.

- We completed the acquisition of the Kelly Agencies, two Leesburg, Virginia based insurance agencies, specializing primarily in group health, life, and disability benefit plans.

- We entered into an agreement during 2007 to acquire Greater Atlantic Financial Corp., a $236 million thrift headquartered in Reston, Virginia. We plan to close the transaction at the end of first quarter 2008.

- Our net interest margin continued to experience pressure, dropping to 3.26% for 2007, compared to 3.38% for 2006. Despite an overall decline in market rates, competitive forces have caused deposit rates to be less sensitive to reductions in market rates.

- Credit quality has declined as our nonperforming assets have increased from $5 million at December 31, 2006 to $12 million at December 31, 2007.

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CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the financial services industry. Application of these principles requires us to make estimates, assumptions, and judgments that affect the amounts reported in our financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

Our most significant accounting policies are presented in Note 1 to the accompanying consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, we have identified the determination of the allowance for loan losses and the valuation of goodwill 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.

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 2 to the accompanying consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of this financial review.

Goodwill is subject to impairment testing at least annually to determine whether write-downs of the recorded balances are necessary. A fair value is determined based on at least one of three various market valuation methodologies. If the fair value equals or exceeds the book value, no write-down of recorded goodwill is necessary. If the fair value is less than the book value, an expense may be required on our books to write down the goodwill to the proper carrying value. During the third quarter of 2007, we completed the required annual impairment test and determined that no impairment write-offs were necessary. We can not assure you that future goodwill impairment tests will not result in a charge to earnings.

See Notes 1 and 10 of the accompanying consolidated financial statements for further discussion of our intangible assets, which include goodwill.

RESULTS OF OPERATIONS

Earnings Summary

Income from continuing operations for the three years ended December 31, 2007, 2006 and 2005, was $13,537,000, $11,060,000, and $8,164,000, respectively. On a per share basis, diluted income from continuing operations was $1.85 in 2007, compared to $1.54 in 2006 and $1.13 in 2005. Consolidated net income, which includes the results of discontinued operations, for the three years ended December 31, 2007, 2006 and 2005 was $6,456,000, $8,257,000, and $10,687,000, respectively. On a per share basis, diluted net income was $0.88 in 2007, compared to $1.15 in 2006 and $1.48 in 2005. Consolidated return on average equity was 7.34% in 2007 compared to 10.44% in 2006 and 15.09% in 2005. Consolidated return on average assets for the year ended December 31, 2007 was 0.50% compared to 0.70% in 2006 and 1.10% in 2005. Included in 2005's income from continuing operations is an other-than-temporary non-cash impairment charge of $1.5 million pre-tax, equivalent to $940,000 after-tax, related to $5.7 million of certain preferred stock issuances of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. A summary of the significant factors influencing our results of operations and related ratios is included in the following discussion.

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Net Interest Income

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

Consolidated net interest income on a fully tax equivalent basis, consolidated average balance sheet amounts, and corresponding average yields on interest earning assets and costs of interest bearing liabilities for the years 2007, 2006 and 2005 are presented in Table I. Table II presents, for the periods indicated, the changes in consolidated interest income and expense attributable to (a) changes in volume (changes in volume multiplied by prior period rate) and (b) changes in rate (change in rate multiplied by prior period volume). Changes in interest income and expense attributable to both rate and volume have been allocated between the factors in proportion to the relationship of the absolute dollar amounts of the change in each. Tables I and II are presented on a consolidated basis. The results would not vary significantly if presented on a continuing operations basis.

Consolidated net interest income on a fully tax equivalent basis, totaled $40,495,000, $37,870,000, and $32,080,000 for the years ended December 31, 2007, 2006 and 2005, respectively, representing a 6.9% increase in 2007 and 18.0% in 2006. These increases in net interest income are the result of substantial loan growth in the commercial real estate and residential mortgage portfolios in all three years, which more than offset the impact of higher funding costs. Total average earning assets increased 10.7% to $1,240,647,000 at December 31, 2007 from $1,121,089,000 at December 31, 2006. Total average interest bearing liabilities increased 10.8% to $1,135,031,000 at December 31, 2007, compared to $1,024,031,000 at December 31, 2006. As identified in Table II, consolidated tax equivalent net interest income grew $2,625,000 and $5,790,000 during 2007 and 2006, respectively.

Our consolidated net interest margin was 3.26% for 2007 compared to 3.38% and 3.51% for 2006 and 2005, respectively. Our consolidated net interest margin decreased 12 basis points in 2007, driven by a 28 basis point increase in the cost of interest bearing funds while the increase on the yields on interest earning assets was only 14 basis points. Our margin continues to be affected by our rapid loan growth in an extremely competitive environment. Despite an overall decline in market rates, competitive forces have caused deposit rates to be less sensitive to reductions in market rates. Unlike in prior years, in many cases, the marginal cost of raising retail time deposits was higher at some points during 2007 than wholesale time deposits. If loan growth continues at levels similar to 2007, this could cause continued margin contraction. Our consolidated net interest margin decreased 13 basis points in 2006, despite an increase of 94 basis points on the yields on interest earning assets, which was more than offset by the 113 basis point increase in the cost of interest bearing liabilities. See Tables I and II for further details regarding changes in volumes and rates of average assets and liabilities and how those changes affect our consolidated net interest income.

We anticipate modest growth in our net interest income to continue over the near term as the growth in the volume of interest earning assets will more than offset the expected continued downward pressure on our net interest margin. 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 of Item 7A for further discussion of the impact changes in market interest rates could have on us.

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TABLE I - AVERAGE DISTRIBUTION OF CONSOLIDATED ASSETS,
LIABILITIES AND SHAREHOLDERS' EQUITY,
INTEREST EARNINGS & EXPENSES, AND
AVERAGE YIELDS/RATES
(dollars in thousands)

	2007			2006			2005		
	Average Balances	Earnings/ Expense	Yield/ Rate	Average Balances	Earnings/ Expense	Yield/ Rate	Average Balances	Earnings/ Expense	Yield/ Rate
ASSETS									
Interest earning assets									
Loans, net of unearned interest (1)									
Taxable	$ 963,116	$ 77,511	8.05%	$ 872,017	$ 68,915	7.90%	$ 691,041	$ 47,582	6.89%
Tax-exempt (2)	9,270	738	7.96%	8,428	642	7.62%	8,688	635	7.31%
Securities									
Taxable	219,605	11,223	5.11%	193,046	9,403	4.87%	164,611	7,076	4.30%
Tax-exempt (2)	47,645	3,289	6.90%	46,382	3,227	6.96%	47,563	3,180	6.69%
Federal Funds sold and interest bearing deposits with other banks	1,011	51	5.04%	1,216	62	5.10%	2,779	109	3.92%
	$ 1,240,647	$ 92,812	7.48%	$ 1,121,089	$ 82,249	7.34%	$ 914,682	$ 58,582	6.40%
Noninterest earning assets									
Cash and due from banks	14,104			13,417			17,583		
Banks premises and equipment	22,179			23,496			21,234		
Other assets	30,795			26,422			21,121		
Allowance for loan losses	(8,683)			(6,849)			(5,652)		
Total assets	$ 1,299,042			$ 1,177,575			$ 968,968		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Liabilities									
Interest bearing liabilities									

Interest bearing demand deposits	$ 227,014	$ 7,695	3.39%	$ 215,642	$ 7,476	3.47%	$ 151,271	$ 3,120	2.06%
Savings deposits	42,254	706	1.67%	42,332	554	1.31%	47,745	312	0.65%
Time deposits	524,389	25,895	4.94%	458,864	20,282	4.42%	319,377	9,970	3.12%
Short-term borrowings	95,437	4,822	5.05%	130,771	6,612	5.06%	138,694	4,824	3.48%
Long-term borrowings and subordinated debentures	245,937	13,199	5.37%	176,422	9,455	5.36%	172,260	8,276	4.80%
	$ 1,135,031	$ 52,317	4.61%	$ 1,024,031	$ 44,379	4.33%	$ 829,347	$ 26,502	3.20%
Noninterest bearing liabilities									
Demand deposits	65,060			64,380			61,543		
Other liabilities	11,000			10,106			7,258		
Total liabilities	1,211,091			1,098,517			898,148		
Shareholders' equity	87,951			79,058			70,820		
Total liabilities and shareholders' equity	$ 1,299,042			$ 1,177,575			$ 968,968		
NET INTEREST EARNINGS		$ 40,495			$ 37,870			$ 32,080	
NET INTEREST MARGIN			3.26%			3.38%			3.51%

(1) For purposes of this table, nonaccrual loans are included in average loan balances. Included in interest and fees on loans are loan fees of $633,000, $636,000 and $469,000 for the years ended December 31, 2007, 2006 and 2005 respectively.

(2) For purposes of this table, interest income on tax-exempt securities and loans has been adjusted assuming an effective combined Federal and state tax rate of 34% for all years presented. The tax equivalent adjustment results in an increase in interest income of $1,428,000, $1,286,000, and $1,271,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

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Table II - Changes in Interest Margin Attributable to Rate and Volume - Consolidated Basis
(dollars in thousands)

	2007 Versus 2006 Increase (Decrease) Due to Change in:			2006 Versus 2005 Increase (Decrease) Due to Change in:		
	Volume	Rate	Net	Volume	Rate	Net
Interest earned on:						
Loans						
Taxable	$ 7,312	$ 1,284	$ 8,596	$ 13,638	$ 7,695	$ 21,333
Tax-exempt	66	30	96	(19)	26	7
Securities						
Taxable	1,341	479	1,820	1,314	1,013	2,327
Tax-exempt	87	(25)	62	(80)	127	47
Federal funds sold and interest bearing deposits with other banks	(10)	(1)	(11)	(73)	26	(47)
Total interest earned on interest earning assets	8,796	1,767	10,563	14,780	8,887	23,667
Interest paid on:						
Interest bearing demand deposits	388	(169)	219	1,676	2,680	4,356
Savings deposits	(1)	153	152	(39)	281	242
Time deposits	3,082	2,531	5,613	5,282	5,030	10,312
Short-term borrowings	(1,786)	(4)	(1,790)	(290)	2,078	1,788
Long-term borrowings and subordinated debentures	3,731	13	3,744	204	975	1,179
Total interest paid on interest bearing liabilities	5,414	2,524	7,938	6,833	11,044	17,877
Net interest income	$ 3,382	$ (757)	$ 2,625	$ 7,947	$ (2,157)	$ 5,790

Noninterest Income

Noninterest income from continuing operations totaled 0.57%, 0.31%, and 0.17% of average assets in 2007, 2006, and 2005, respectively. Noninterest income from continuing operations totaled $7,357,000 in 2007, compared to $3,633,000 in 2006 and $1,605,000 in 2005, with service fees from deposit accounts and insurance commissions being the primary components. Further detail regarding noninterest income from continuing operations is reflected in the following table.

Noninterest Income - Continuing Operations (dollars in thousands)	2007	2006	2005
Insurance commissions	$ 2,876	$ 924	$ 853
Service fees	3,004	2,758	2,589
Securities gains (losses)	-	-	(1,390)
Net cash settlement on derivative instruments	(727)	(534)	181
Change in fair value of derivative instruments	1,478	(90)	(950)
(Loss) on sale of assets	(33)	(47)	(198)
Other	759	622	520
Total	$ 7,357	$ 3,633	$ 1,605

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Insurance commissions: These commissions increased over 200% in 2007 due to our acquisition of the Kelly Agencies, two insurance agencies specializing in group health, life and disability benefit plans.

Service fees: Total service fees increased 8.9% in 2007 and 6.5% in 2006 primarily as a result of increases in overdraft and nonsufficient funds (NSF) fees due to an increased overdraft usage by customers and a change in our fee structure.

Securities gains/losses: During 2005, we took an other-than-temporary non-cash impairment charge of $1.5 million pre-tax, equivalent to $940,000 after-tax, related to $5.7 million of certain preferred stock issuances of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Change in fair value of derivative instruments: During 2007, the fair value of derivative financial instruments not eligible for short-cut accounting, net of cash payments received/paid, increased $1,478,000. During 2006, the fair value, net of cash payments, of these derivatives decreased $90,000. The 2007 increase is attributable to the expectation of falling short-term market interest rates which positively impacts the fair value of related derivative instruments.

Losses on sales of assets: Included in noninterest income are losses on sales of assets of $33,000 in 2007, $47,000 in 2006 and $198,000 in 2005. The $198,000 loss in 2005 includes the loss on the sale of one of our foreclosed properties.

Noninterest Expense

Noninterest expense for continuing operations was well controlled in both 2007 and 2006. These expenses totaled $25,098,000 $21,609,000, and $19,264,000 or 1.9%, 1.8%, and 2.0% of average assets for each of the years ended December 31, 2007, 2006 and 2005, respectively. Total noninterest expense for continuing operations increased $3,489,000 in 2007 compared to 2006 and $2,345,000 in 2006 compared to 2005. Table III below shows the breakdown of these increases.

Salaries and employee benefits: Salaries and employee benefits expense increased 23.6% in 2007 primarily due to increased staffing as a result of the acquisition of the Kelly Agencies. These expenses increased 9.4% in 2006 primarily due to general merit raises, and additional staffing requirement needed as a result of our growth, including opening a new community banking office in Martinsburg, West Virginia.

Net occupancy and Equipment expense: The increases in net occupancy and equipment expense for 2007 and 2006 are attributed to increased facility costs as a result of acquiring the Kelly Agencies in 2007 and opening a new branch in 2006.

Other: Other expenses increased $434,000 or 10.3% during 2007. The two largest contributors to this increase were FDIC assessment, which totaled $290,000 in 2007 compared to $88,000 in 2006 due to an increase in assessment rates by the FDIC and ATM/debit card expense, which totaled $513,000 in 2007 compared to $387,000 in 2006 due to increased card usage by customers.

Table III - Noninterest Expense - Continuing Operations (dollars in thousands)	Change	Change

	2007	$	%	2006	$	%	2005
Salaries and employee benefits	$ 14,608	$ 2,787	23.6%	$ 11,821	$ 1,011	9.4%	$ 10,810
Net occupancy expense	1,758	201	12.9%	1,557	186	13.6%	1,371
Equipment expense	2,004	103	5.4%	1,901	188	11.0%	1,713
Supplies	871	74	9.3%	797	248	45.2%	549
Professional fees	695	(197)	-22.1%	892	144	19.3%	748
Advertising	271	(13)	-4.6%	284	(127)	-30.9%	411
Amortization of intangibles	251	100	66.2%	151	-	0.0%	151
Other	4,640	434	10.3%	4,206	695	19.8%	3,511
Total	$ 25,098	$ 3,489	16.1%	$ 21,609	$ 2,345	12.2%	$ 19,264

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Income Tax Expense

Income tax expense for continuing operations for the three years ended December 31, 2007, 2006 and 2005 totaled $5,734,000, $5,018,000, and $3,033,000, respectively. Refer to Note 13 of the accompanying consolidated financial statements for further information and additional discussion of the significant components influencing our effective income tax rates.

CHANGES IN FINANCIAL POSITION

Total average assets in 2007 were $1,299,042,000, an increase of 10.3% over 2006's average of $1,177,575,000. Average assets grew 21.5% in 2006, from $968,968,000 in 2005. This growth principally occurred in our loan portfolio in both years. Significant changes in the components of our balance sheet in 2007 and 2006 are discussed below.

Loan Portfolio

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

Table IV - Loans by Type
Dollars in thousands

	2007		2006		2005		2004		2003	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Commercial	$ 92,599	8.7%	$ 69,470	7.5%	$ 63,206	7.9%	$ 53,226	8.7%	$ 46,860	9.3%
Commercial real estate, land development, and construction	609,748	57.4%	530,018	57.3%	407,435	50.8%	283,547	46.6%	211,760	42.0%
Residential mortgage	322,640	30.3%	282,512	30.5%	285,241	35.6%	223,690	36.7%	196,135	38.9%
Consumer	31,956	3.0%	36,455	3.9%	36,863	4.6%	38,948	6.4%	41,112	8.2%
Other	6,641	0.6%	6,969	0.8%	8,598	1.1%	9,605	1.6%	8,223	1.6%
Total loans	$ 1,063,584	100.0%	$ 925,424	100.0%	$ 801,343	100.0%	$ 609,016	100.0%	$ 504,090	100.0%

Total net loans averaged $972,386,000 in 2007 and comprised 74.9% of total average assets compared to $880,445,000 or 74.8% of total average assets during 2006. The increase in the dollar volume of loans is primarily attributable to our continued growth mode. We continue to aggressively seek loans in the Virginia markets, primarily in the Shenandoah Valley of northern Virginia, as this area is currently a vibrant market for commercial loans, especially commercial real estate loans.

Refer to Note 6 of the accompanying consolidated financial statements for our loan maturities and a discussion of our adjustable rate loans as of December 31, 2007.

In the normal course of business, we make various commitments and incur certain contingent liabilities, which are disclosed in Note 15 of the accompanying consolidated financial statements but not reflected in the accompanying consolidated financial statements. There have been no significant changes in these types of commitments and contingent liabilities and we do not anticipate any material losses as a result of these commitments.

Securities

Securities comprised approximately 20.9% of total assets at December 31, 2007 compared to 20.1% at December 31, 2006. Average securities approximated $267,250,000 for 2007 or 11.6% more than 2006's average of $239,428,000. Refer to Note 5 of the accompanying consolidated financial statements for details of amortized cost, the estimated fair values, unrealized gains and losses as well as the security classifications by type.

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All of our securities are classified as available for sale to provide us with flexibility to better manage our balance sheet structure and react to asset/liability management issues as they arise. Pursuant to SFAS No. 115, anytime that we carry a security with an unrealized loss that has been determined to be “other than temporary”, we must recognize that loss in income. During 2005, we took an other-than-temporary non-cash impairment charge of $1.5 million pre-tax, equivalent to $940,000 after-tax, related to $5.7 million of certain preferred stock issuances of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. We continue to own these securities, and this charge was taken primarily due to difficulty in accurately projecting the future recovery period of these securities. At December 31, 2007, we did not own securities of any one issuer that were not issued by the U.S. Treasury or a U.S. Government agency that exceeded ten percent of shareholders’ equity. The maturity distribution of the securities portfolio at December 31, 2007, together with the weighted average yields for each range of maturity, is summarized in Table V. The stated average yields are actual yields and are not stated on a tax equivalent basis.

Table V - Securities Maturity Analysis
(At amortized cost, dollars in thousands)

	Within one year		After one but within five years		After five but within ten years		After ten years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U. S. Government agencies and corporations	$ 6,771	4.2%	$ 9,432	4.8%	$ 27,675	5.3%	$ 1,993	6.4%
Mortgage backed securities	47,315	4.9%	89,302	5.1%	31,040	5.5%	13,179	5.5%
State and political subdivisions	162	6.3%	5,372	5.9%	12,883	6.8%	29,303	6.9%
Corporate debt securities	1,000	3.7%	349	6.8%	-	-	-	-
Other	-	-	-	-	-	-	24,365	5.9%
Total	$ 55,248	4.8%	$ 104,455	5.1%	$ 71,598	5.7%	$ 68,840	6.0%

Deposits

Total deposits at December 31, 2007 decreased $60,000,000 or 6.8% compared to December 31, 2006. Average interest bearing deposits increased $76,819,000, or 10.7% during 2007. We have strengthened our focus on growing retail deposits, which is reflected by their steady growth over the past two years, increasing 7.1% in 2007 and 11.7% in 2006. Wholesale deposits, which represent brokered certificates of deposit acquired through a third party, decreased 36.9% to $176,391,000 at December 31, 2007. These deposits totaled $279,623,000 at December 31, 2006, an increase of 117.3% over 2005. Our decreased utilization of brokered deposits during 2007 was due to favorable pricing of other alternative wholesale funding sources, including wholesale reverse repurchase agreements. During 2006, the pricing of brokered certificates of deposits was more favorable when compared to other wholesale funding sources, and were used to pay off short term Federal Home Loan Bank advances.

Deposits

(dollars in thousands)

	2007	2006	2005	2004	2003
Noninterest bearing demand	$ 65,727	$ 62,591	$ 62,617	$ 55,402	$ 51,004
Interest bearing demand	222,825	220,167	200,638	122,355	112,671
Savings	40,845	47,984	44,681	50,428	47,397
Certificates of deposit	291,294	249,952	211,032	217,863	241,351
Individual Retirement Accounts	31,605	28,370	26,231	25,298	26,185
Retail deposits	652,296	609,064	545,199	471,346	478,608
Wholesale deposits	176,391	279,623	128,688	53,268	33,193
Total deposits	$ 828,687	$ 888,687	$ 673,887	$ 524,614	$ 511,801

See Table I for average deposit balance and rate information by deposit type for 2007, 2006 and 2005 and Note 11 of the accompanying consolidated financial statements for a maturity distribution of time deposits as of December 31, 2007.

Borrowings

Lines of Credit: We have available lines of credit from various correspondent banks totaling $18,183,000 at December 31, 2007. These lines are utilized when temporary day to day funding needs arise. They are reflected on the consolidated balance sheet as short-term borrowings. We also have remaining available lines of credit from the Federal Home Loan Bank totaling $230,225,000 at December 31, 2007. We use these lines primarily to fund loans to customers. Funds acquired through this program are reflected on the consolidated balance sheet in short-term borrowings or long-term borrowings, depending on the repayment terms of the debt agreement. We also had $23 million available on a short term line of credit with the Federal Reserve Bank at December 31, 2007, which is primarily secured by consumer loans, and certain construction loans. In addition, Summit Financial Group, Inc. has a long-term line of credit available through an unaffiliated banking institution which is secured by the common stock of our subsidiary bank. At December 31, 2007, we had $4,250,000 available to draw on this line.

Short-term Borrowings: Total short-term borrowings increased $111,627,000 from $60,428,000 at December 31, 2006 to $172,055,000 at December 31, 2006. These borrowings principally replaced brokered certificates of deposits. See Note 12 of the accompanying consolidated financial statements for additional disclosures regarding our short-term borrowings.

Long-term Borrowings: Total long-term borrowings of $315,738,000 at December 31, 2007, consisted primarily of funds borrowed on available lines of credit from the Federal Home Loan Bank and structured reverse repurchase agreements with two unaffiliated institutions. Borrowings from the Federal Home Loan Bank increased $29,628,000 to $205,738,000 compared to the $176,110,000 outstanding at December 31, 2006. During 2007, we entered into $110,000,000 of structured reverse repurchase agreements which have embedded interest rate caps, with terms ranging from 4 to 6 years and call features ranging from 2 to 3 years in which they are callable by the purchaser. Long term borrowings were principally used to fund our loan growth. Refer to Note 12 of the accompanying consolidated financial statements for additional information regarding our long-term borrowings.

ASSET QUALITY

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

Table VI - Nonperforming Assets
(dollars in thousands)

	2007	2006	2005	2004	2003
Nonaccrual loans	$ 2,917	$ 638	$ 583	$ 532	$ 1,014
Accruing loans past due					
90 days or more	7,416	4,638	799	140	342
Total nonperforming loans	10,333	5,276	1,382	672	1,356
Foreclosed properties and					
repossessed assets	2,058	77	285	646	497
Nonaccrual securities	-	-	-	349	396
Total nonperforming assets	$ 12,391	$ 5,353	$ 1,667	$ 1,667	$ 2,249
Total nonperforming loans					

as a percentage of total loans	0.97%	0.57%	0.17%