SUMMIT FINANCIAL GROUP INC
Form 10-K/A
April 23, 2009

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

FORM 10-K/A
(Amendment No. 1)

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

For the fiscal year ended December 31, 2008

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)

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No 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 to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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, 2008, was approximately $68,402,000. The number of shares of the Registrant's Common Stock outstanding on March 2, 2009, was 7,415,310. (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/A, and the Parts and Items of the Form 10-K/A into which the documents are incorporated.

Document	Part of Form 10-K/A into which document is incorporated
Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 14, 2009	Part III - Items 10, 11, 12, 13, and 14

Explanatory Note

This Amendment No. 1 to our Annual Report on Form 10-K, which was originally filed March 16, 2009, is being filed to amend the following items:

- We inadvertently omitted the disclosure that none of our authorized Preferred Stock was outstanding for any of the periods presented in the shareholders' equity sections of the balance sheets included in the financial statements;
- We inadvertently omitted the conformed signatures of our Independent Registered Public Accounting Firm on their reports included in the original filing. All reports were manually signed by our Independent Registered Public Accounting Firm on March 13, 2009; and
- We are including a revised Report of Independent Registered Public Accounting Firm on Effectiveness of Internal Control Over Financial Reporting. Our Independent Registered Public Accountant inadvertently submitted the Internal Control Attestation Engagement under AT 501 (FDICIA) instead of the opinion required by Public Accounting Standard Oversight Board Standard No. 5.

In addition, as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications by our principal executive officer and principal financial officer are filed herewith as Exhibits 31.1, 31.2, 32.1 and 32.2.

This Amendment No. 1 on Form 10-K/A does not modify or update the disclosures set forth in the original filing, including the financial statements and notes to the financial statements set forth in the 2008 Form 10-K, except as described above.

For ease of reference, we are including the entire 10-K/A document in this amendment.

SUMMIT FINANCIAL GROUP, INC
Form 10-K/A Index

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 $1.6 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 Summit Community to develop long-term customer relationships, maintain high quality service and respond quickly to customer needs. We believe that our emphasis on local relationship banking, together with a 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.

FDIC Assessments

In late 2008, the FDIC raised assessment rates for the first quarter of 2009 by a uniform 7 basis points, resulting in a range between 12 and 50 basis points, depending upon the risk category. At the same time, the FDIC proposed further changes in the assessment system beginning in the second quarter of 2009. These changes commencing April 1, 2009, would set base assessment rates between 10 and 45 basis points, depending on the risk category, but would apply adjustments (relating to unsecured debt, secured liabilities, and brokered deposits) to individual institutions that could result in assessment rates between 8 and 21 basis points for institutions in the lowest risk category and 43 to 77.5 basis points for institutions in the highest risk category. A final rule to be issued in early 2009 could adjust these assessment rates further in light of developing conditions. The purpose of the April 1, 2009 changes is to ensure that riskier institutions will bear a greater share of the proposed increase in assessments, and will be subsidized to a lesser degree by less risky institutions. The changes are also part of an FDIC plan to restore the designated reserve ratio to 1.25% by 2013.

On February 27, 2009, the FDIC approved an interim rule to institute a one-time special assessment of 20 cents per $100 in domestic deposits to restore the DIF reserves depleted by recent bank failures. The interim rule additionally reserves the right of the FDIC to charge an additional up-to-10 basis point special premium at a later point if the DIF reserves continue to fall. The FDIC also approved an increase in regular premium rates for the second quarter of 2009. For most banks, this will be between 12 to 16 basis points per $100 in domestic deposits. Premiums for the rest of 2009 have not yet been set. The FDIC noted it would consider reducing the special one-time assessment to 10 cents if the U.S. Congress were to approve an increase in its operating line of credit with the U.S. Treasury.

Recent Legislative and Regulatory Initiatives to Address Financial and Economic Crisis

The Congress, Treasury and the federal banking regulators, including the FDIC, have taken broad action since early September 2008 to address volatility in the U.S. financial system.

In October 2008, the Emergency Economic Stabilization Act (“EESA”) was enacted. EESA authorizes Treasury to purchase from financial institutions and their holding companies up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies under the Troubled Assets Relief Program (“TARP”). The purpose of TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. Treasury has allocated $250 billion towards the TARP's Capital Purchase Program (“CPP”). Under the CPP, Treasury will purchase debt or equity securities from participating institutions. The TARP also will include direct purchases or guarantees of troubled assets of financial institutions. Participants in the CPP are subject to executive compensation limits and are encouraged to expand their lending and mortgage loan modifications. The American Recovery and Reinvestment Act of 2009 ("ARRA"), as described below, has further modified TARP and the CPP.

ARRA was signed into law on February 17, 2009. ARRA contains a wide variety of programs intended to stimulate the economy and provides for extensive infrastructure, energy, health, and education needs. In addition, ARRA imposes certain new executive compensation and corporate expenditure limits on all current and future TARP recipients.

EESA also increased FDIC deposit insurance on most accounts from $100,000 to $250,000 through 2009.

Following a systemic risk determination, the FDIC established a Temporary Liquidity Guarantee Program ("TLGP") on October 14, 2008. The TLGP includes the Transaction Account Guarantee Program ("TAGP"), which provides unlimited deposit insurance coverage through December 31, 2009 for noninterest-bearing transaction accounts (including all demand deposit checking accounts) and certain funds swept into noninterest-bearing savings accounts. Institutions participating in the TAGP pay a 10 basis points fee (annualized) on the balance of each covered account in excess of $250,000, while the extra deposit insurance is in place. The TLGP also includes the Debt Guarantee Program ("DGP"), under which the FDIC guarantees certain senior unsecured debt of FDIC-insured institutions and their holding companies. The unsecured debt must be issued on or after October 14, 2008 and not later than June 30, 2009, and the guarantee is effective through the earlier of the maturity date or June 30, 2012. The DGP coverage limit is generally 125% of the eligible entity's eligible debt outstanding on September 30, 2008 and scheduled to mature on or before June 30, 2009 or, for certain insured institutions, 2% of their liabilities as of September 30, 2008. Depending on the term of the debt maturity, the nonrefundable DGP fee ranges from 50 to 100 basis points (annualized) for covered debt outstanding until the earlier of maturity or June 30, 2012. The TAGP and DGP are in effect for all eligible entities, unless the entity opted out on or before December 5, 2008. Summit and Summit Community participate in the TAGP and did not opt out of the DGP. As of March 2, 2009, neither had utilized the DGP by issuing senior unsecured debt.

Permitted Non-banking Activities

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

Credit and Monetary Policies and Related Matters

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

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

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 Summit Community's capital ratios as of year end 2008 are set forth in the table in Note 17 of the notes to the consolidated financial statements on page 73.

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, 2008. 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.

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.

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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, 2009, we employed 238 full-time equivalent employees.

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Available Information

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

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

Statistical Information

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

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Item 1A. Risk Factors

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

Risks Relating to the Economic Environment

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

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

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

In addition, further negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial services industry.

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

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

Substantially all of our real estate loans are located in West Virginia and Virginia. While we do not have any sub-prime loans, our construction and development and residential real estate loan portfolios, along with our commercial real estate loan portfolio and certain of our other loans, have been affected by the recent downturn in the residential and commercial real estate market. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature. We anticipate that further declines in the real estate markets in our primary market areas would affect our business. If real estate values continue to decline, the collateral for our loans will provide less security. As a result, our ability to recover on defaulted loans by selling the underlying real estate will be diminished, and we would be more likely to suffer losses on defaulted loans. The events and conditions described in this risk factor could therefore have a material adverse effect on our business, results of operations and financial condition.

The soundness of other financial institutions could adversely affect us.

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

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

There can be no assurance that the recently enacted emergency economic stabilization act of 2008 (the "EESA") and other recently enacted government programs will help stabilize the U.S. financial system.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the "EESA") was enacted. The U.S. Treasury and banking regulators are implementing a number of programs under this legislation and otherwise to address capital and liquidity issues in the banking system, including the Troubled Assets Relief Program Capital Purchase Program, and the Capital Assistance Program. In addition, other regulators have taken steps to attempt to stabilize and add liquidity to the financial markets, such as the FDIC Temporary Liquidity Guarantee Program ("TLG Program"), in which we are a participant. However, there can be no assurance that we will issue any guaranteed debt under the TLG Program, or that we will participate in any other stabilization programs in the future.

There can also be no assurance as to the actual impact that the EESA and other programs will have on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of the EESA and other programs to stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common stock.

The EESA is relatively new legislation and, as such, is subject to change and evolving interpretation. This is particularly true given the change in administration that occurred on January 20, 2009. There can be no assurances as to the effects that such changes will have on the effectiveness of the EESA or on our business, financial condition or results of operations.

Risks Relating to Our Business

Although we believe our allowance for loan and lease losses is sufficient to absorb all credit losses inherent in our portfolio, if our allowance for loan and lease losses is inadequate, it could materially and adversely affect our business, financial condition, results of operations, cash flows and/or future prospects.

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

We attempt to maintain an appropriate allowance for loan and lease losses to provide for losses inherent in our loan and lease portfolio. As of December 31, 2008, our allowance for loan and lease losses totaled $16.9 million, which represents approximately 1.40% of our total loans and leases. There is no precise method of predicting loan and lease losses, and therefore, we always face the risk that charge-offs in future periods will exceed our allowance for loan and lease losses and that we would need to make additional provisions to our allowance for loan and lease losses.

Our methodology for the determination of the adequacy of the allowance for loan and lease losses for impaired loans is based on classifications of loans and leases into various categories and the application of SFAS No. 114, as amended. For non-classified loans, the estimated allowance is based on historical loss experiences as adjusted for changes in trends and conditions on at least an annual basis. In addition, on a quarterly basis, the estimated allowance for non-classified loans is adjusted for the probable effect that current environmental factors could have on the historical loss factors currently in use. While our allowance for loan and lease losses is established in different portfolio components, we maintain an allowance that we believe is sufficient to absorb all credit losses inherent in our portfolio.

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

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

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

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions and a number of other factors, many of which are outside our control, and on our financial performance. Accordingly, we cannot be assured of our ability to raise additional capital if needed or on terms acceptable to us. If we cannot raise additional capital when needed, it may have a material adverse effect on our financial condition, results of operations and prospects.

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

We have frequently utilized as a source of funds certificates of deposit obtained through deposit brokers that solicit funds from their customers for deposit with us, or brokered deposits. Brokered deposits, when compared to retail deposits attracted through a branch network, are generally more sensitive to changes in interest rates and volatility in the capital markets and could reduce our net interest spread and net interest margin. In addition, brokered deposit funding sources may be more sensitive to significant changes in our financial condition. As of December 31, 2008, brokered deposits totaled $296.6 million, or approximately 33.1% of our total deposits, compared to brokered deposits in the amount of $176.4 million or approximately 23.1% of our total deposits at December 31, 2007. As of December 31, 2008, approximately $140.2 million in brokered deposits, or approximately 34.8% of our total brokered deposits, are short-term and mature within one year. Our ability to continue to acquire brokered deposits is subject to our ability to price these deposits at competitive levels, which may increase our funding costs, and the confidence of the market. In addition, if our capital ratios fall below the levels necessary to be considered “well-capitalized” under current regulatory guidelines, we could be restricted from using brokered deposits as a funding source.

We also have short-term borrowings with the Federal Home Loan Bank, or the FHLB. As of December 31, 2008, our FHLB short-term borrowings totaled $142.3 million and mature within one year. If we were unable to borrow from the FHLB in the future, we may be required to seek higher cost funding sources, which could materially and adversely affect our net interest income.

Summit operates in a very competitive industry and market.

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

Changes in interest rates could negatively impact our future earnings.

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

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

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

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

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

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

On February 27, 2009, the FDIC approved an interim rule to institute a one-time special assessment of 20 cents per $100 in domestic deposits to restore the DIF reserves depleted by recent bank failures. The interim rule additionally reserves the right of the FDIC to charge an additional up-to-10 basis point special premium at a later point if the Deposit Insurance Fund reserves continue to fall. The FDIC also approved an increase in regular premium rates for the second quarter of 2009. For most banks, this will be between 12 to 16 basis points per $100 in domestic deposits. Premiums for the rest of 2009 have not yet been set. The FDIC noted it would consider reducing the special one-time assessment to 10 cents if the U.S. Congress were to approve an increase in its operating line of credit with the U.S. Treasury. Either an increase in the Risk Category of Summit Community Bank or adjustments to the base assessment rates could have a material adverse effect on our earnings.

The value of securities in our investment securities portfolio may be negatively affected by continued disruptions in securities markets.

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

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

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

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

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposits, servicing or loan origination systems. Although we have policies and procedures designed to prevent or minimize the effect of a failure, interruption or breach in security of our communications or information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur, or if they do occur, that they will be adequately addressed. The occurrence of any such failures, interruptions or security breaches could result in a loss of customer business and have a negative effect on our results of operations, financial condition and cash flows.

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

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

Risks Relating to an Investment in Our Common Stock

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

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

- Changes in interest rates
- New developments in the banking industry
- Variations in our quarterly or annual operating results
- New litigation or changes in existing litigation
- Regulatory actions

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

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

As of December 31, 2008, our executive officers and directors beneficially own 24.45% of the outstanding shares of our common stock. Accordingly, these executive officers and directors will be able to impact, the outcome of all matters required to be submitted to our stockholders for approval, including decisions relating to the election of directors, the determination of our day-to-day corporate and management policies and other significant corporate transactions.

Your share ownership may be diluted by the issuance of additional shares of our common stock in the future.

Your share ownership may be diluted by the issuance of additional shares of our common stock in the future. In 1998, we adopted a stock option plan (the "1998 Plan") that provided for the granting of stock options to our directors, executive officers and other employees. Although the 1998 Plan expired in May, 2008, as of December 31, 2008, 335,730 shares of our common stock are still issuable under options granted in connection with our 1998 Plan. Our Board of Directors has approved the adoption of a new stock officer plan and we are submitting this plan to our shareholders at our 2009 Annual Meeting of shareholders for approval. If approved, 350,000 shares of common stock will be available for issuance under the plan. It is probable that the stock options will be exercised during their respective terms if the fair market value of our common stock exceeds the exercise price of the particular option. If the stock options are exercised, your share ownership will be diluted.

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

We rely on dividends from our subsidiary bank for most of our revenue.

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

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

We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the "capital securities") for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the "debentures"). The debentures held by the trusts are their sole assets. Our subordinated debentures of these unconsolidated statutory trusts totaled $19,589,000 at December 31, 2008 and 2007.

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

Payments of the principal and interest on the trust preferred securities of the statutory trusts are conditionally guaranteed by us. The junior subordinated debentures are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We have the right to defer distributions on the junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on our common stock. In 2008, our total interest payments on these junior subordinated debentures approximated $1,200,000. Based on current rates, our quarterly interest payment obligation on our junior subordinated debentures is approximately $200,000.

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

We have also issued $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. Like the junior subordinated debentures, the subordinated debt is senior to our common stock and we must make payments on the subordinated debt before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the subordinated debt must be satisfied before any distributions can be made on our common stock. The subordinated debt qualifies as Tier 2 capital under Federal Reserve Board guidelines. Our total interest payments on this subordinated debt in 2008 was approximately $390,000. Based upon the current rate, our quarterly interest payment obligation on this debt is approximately $80,000.

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

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

Your shares are not an insured deposit.

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

Other

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

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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. Summit Community's headquarters and branch locations occupy offices which are either owned or operated under long-term lease arrangements. At December 31, 2008, Summit Community operated 15 banking offices. Summit Insurance Services, LLC operates out of the Moorefield, West Virginia office of Summit Community, 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 9 and 10 of our consolidated financial statements on page 64.

Item 3. Legal Proceedings

Information required by this item is set forth under the caption "Litigation" in Note 16 of our consolidated financial statements on page 72.

Item 4. Submission of Matters to a Vote of Shareholders

No matters were submitted during the fourth quarter of 2008 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
2008				
Dividends paid	$ -	$ 0.18	$ -	$ 0.18
High Bid	16.25	14.47	13.55	12.00
Low Bid	13.51	12.50	10.05	7.74
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

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 17 of the notes to the accompanying consolidated financial statements.

As of March 1, 2009, there were approximately 1,290 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 are 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, 2008.

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, 2008 - October 31, 2008	-	$ -	-	165,375
November 1, 2008 - November 30, 2008	14,194	8.86	-	165,375
December 1, 2008 - December 31, 2008	3,985	8.71	-	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.

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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, 2008. 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, 2003 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, 2008. 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.

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Dollars in thousands, except per share amounts	For the Year Ended (unless otherwise noted) 2008	2007	2006	2005	2004
Summary of Operations					
Interest income	$ 93,484	$ 91,384	$ 80,278	$ 56,653	$ 45,041
Interest expense	49,409	52,317	44,379	26,502	18,663
Net interest income	44,075	39,067	35,899	30,151	26,378
Provision for loan losses	15,500	2,055	1,845	1,295	1,050
Net interest income after provision for loan losses	28,575	37,012	34,054	28,856	25,328
Noninterest income	2,868	7,357	3,634	1,605	3,263
Noninterest expense	29,434	25,098	21,610	19,264	16,919
Income before income taxes	2,009	19,271	16,078	11,197	11,672
Income tax expense (benefit)	(291)	5,734	5,018	3,033	3,348
Income from continuing operations	2,300	13,537	11,060	8,164	8,324
Discontinued operations					
Exit costs and impairment of long-lived assets	-	(312)	(2,480)	-	-
Operating income (loss)	-	(10,347)	(1,750)	3,862	2,913
Income (loss) from discontinued operations before tax	-	(10,659)	(4,230)	3,862	2,913
Income tax expense (benefit)	-	(3,578)	(1,427)	1,339	1,004
Income (loss) from discontinued operations	-	(7,081)	(2,803)	2,523	1,909
Net income	$ 2,300	$ 6,456	$ 8,257	$ 10,687	$ 10,233
Balance Sheet Data (at year end)					
Assets	$ 1,627,116	$ 1,435,536	$ 1,235,519	$ 1,110,214	$ 889,830
Securities available for sale	327,606	283,015	235,780	208,011	197,519
Loans	1,192,157	1,052,489	916,045	793,452	602,728
Deposits	965,850	828,687	888,687	673,887	524,596
Short-term borrowings	153,100	172,055	60,428	182,028	120,629
Long-term borrowings	392,748	315,738	176,110	152,706	161,760
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589	19,589	11,341
Shareholders' equity	87,244	89,420	78,752	72,691	65,150
Per Share Data					
Earnings per share from continuing operations					
Basic earnings	$ 0.31	$ 1.87	$ 1.55	$ 1.15	$ 1.18
Diluted earnings	0.31	1.85	1.54	1.13	1.17

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	0.31	0.89	1.16	1.51	1.46
Diluted earnings	0.31	0.88	1.15	1.48	1.44
Shareholders' equity (at year end)	11.77	12.07	11.12	10.20	9.25
Cash dividends	0.36	0.34	0.32	0.30	0.26
Performance Ratios					
Return on average equity	2.59%	7.34%	10.44%	15.09%	16.60%
Return on average assets	0.15%	0.50%	0.70%	1.10%	1.22%
Dividend payout	116.0%	38.1%	27.6%	20.0%	17.9%
Equity to assets	5.4%	6.2%	6.4%	6.5%	7.3%

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

FORWARD LOOKING STATEMENTS

This annual report contains comments or information that constitute forward looking statements (within the meaning of the Private Securities Litigation Act of 1995) that are based on current expectations that involve a number of risks and uncertainties. Words such as “expects”, “anticipates”, “believes”, “estimates” and other similar expressions or future or conditional verbs such as “will”, “should”, “would” and “could” are intended to identify such forward-looking statements. The Private Securities Litigation Act of 1995 indicates that the disclosure of forward-looking information is desirable for investors and encourages such disclosure by providing a safe harbor for forward-looking statements by us. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed in those forward-looking statements.

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

DESCRIPTION OF BUSINESS

We are a $1.6 billion community-based financial services company providing a full range of banking and other financial services to individuals and businesses through our two operating segments: community banking and insurance. Our community bank, Summit Community Bank, has a total of 15 banking offices located in West Virginia and Virginia. In addition, we also operate an insurance agency, Summit Insurance Services, LLC with an office in Moorefield, West Virginia which offers both commercial and personal lines of insurance and two offices in Leesburg, Virginia, primarily specializing in group health, life and disability benefit plans. 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 2008

- Net income for 2008 totaled $2.3 million compared to $13.5 million income from continuing operations in 2007. The decline is primarily a result of higher loan loss provisions and other-than-temporary impairment on securities.

- We strengthened our allowance for loan losses to reflect the weaker economy and its current and future impact on asset quality. The $15.5 million loan loss provision recorded this year raised the allowance for loan losses to 1.40 percent of total loans at year-end, after net loan charge-offs of $7.8 million during the course of the year.

- We felt the impact of the housing crisis as reflected by the impairment of our investments in Freddie Mac and Fannie Mae preferred stock resulting in $6.4 million in charges recorded relative to these securities in 2008.

- Asset growth of 13.3 percent was primarily driven by loan growth of $147.9 million, or 13.9 percent year-over-year, which was derived principally from commercial and commercial real estate loans.

- We are experiencing the challenges related to the current economic environment, as evidenced by the dramatic increase in nonperforming assets at December 31, 2008, climbing to $56 million from $12 million one year ago. Our loan quality was impacted by the contracting economy and commercial real estate market, which caused declines in real estate values and deterioration in financial condition of various borrowers. These conditions led to our downgrading the loan quality ratings on various real estate loans through our normal loan review process. In addition, several impaired loans became under-collateralized due to the reduction in the estimated net realizable fair value of the underlying collateral.

- Stability of the net interest margin; this continues to be a highlight of our performance despite the rapid decline of interest rates beginning in third quarter 2007. However, the impact of foregone interest income from nonaccruing loans has negatively impacted the margin during the last two quarters of 2008.

- We remained well-capitalized by regulatory capital guidelines at December 31, 2008, however access to new capital resources is presently constrained.

- We mutually terminated the Greater Atlantic merger agreement.

OUTLOOK

Summit remains well-capitalized, adequately reserved and profitable. The Company has adequate liquidity and is positioned to weather the current economic conditions and return to increased profitability when conditions improve. In the short-term, however, Management anticipates the Company's net income and earnings per common share will continue to be negatively impacted, probably significantly, by continuing high levels of loan losses and nonperforming assets, a weak economy, low asset and revenue growth, low interest rates, and higher FDIC premiums.

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, the valuation of goodwill and fair value measurements 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 1 to the accompanying consolidated financial statements describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of this financial review.

Goodwill: Goodwill is subject to 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 2008, 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 11 of the accompanying consolidated financial statements for further discussion of our intangible assets, which include goodwill.

Fair Value Measurements: We adopted Statement of Financial Accounting Standards No. 157 (“SFAS 157”), Fair Value Measurements, on January 1, 2008. This standard 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 SFAS 157. Fair value determination in accordance with SFAS 157 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 SFAS No. 107, Disclosures About Fair Value of Financial Instruments.

RESULTS OF OPERATIONS

Earnings Summary

Income from continuing operations for the three years ended December 31, 2008, 2007 and 2006, was $2,300,000, $13,537,000, and $11,060,000, respectively. On a per share basis, diluted income from continuing operations was $0.31 in 2008 compared to $1.85 in 2007, and $1.54 in 2006. Consolidated net income, which includes the results of discontinued operations, for the three years ended December 31, 2008, 2007, and 2006 was $2,300,000, $6,456,000, and $8,257,000, respectively. On a per share basis, diluted net income was $0.31 in 2008, compared to $0.88 in 2007 and $1.15 in 2006. Consolidated return on average equity was 2.59% in 2008 compared to 7.34% in 2007 and 10.44% in 2006. Consolidated return on average assets for the year ended December 31, 2008 was 0.15% in 2008 compared to 0.50% in 2007 and 0.70% in 2006. Included in 2008’s net income is a $15.5 million loan loss provision and an other-than-temporary non-cash impairment charge of $6.4 million pre-tax, equivalent to $4.0 million after-tax, related to $8.0 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.

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 2008, 2007 and 2006 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 $45,438,000, $40,495,000, and $37,870,000, for the years ended December 31, 2008, 2007 and 2006, respectively, representing a 12.2% increase in 2008 and 6.9% in 2007. 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. Total average earning assets increased 17.0% to $1,451,326,000 at December 31, 2008 from $1,240,647,000 at December 31, 2007. Total average interest bearing liabilities increased 18.6% to $1,345,948,000 at December 31, 2008, compared to $1,135,031,000 at December 31, 2007. As identified in Table II, consolidated tax equivalent net interest income grew $4,943,000 and $2,625,000 during 2008 and 2007, respectively.

Our consolidated net interest margin was 3.13% for 2008 compared to 3.26% and 3.38% for 2007 and 2006, respectively. Our consolidated net interest margin decreased 13 basis points in 2008, driven primarily by the reversal of loan interest income related to nonaccrual loans placed on nonaccrual status during late 2008 and the continued reduction in interest income as a result of these loans remaining on nonaccrual status, and by a slight change in our balance sheet mix as the 94 basis point decrease in the yield on interest earning assets was mirrored by a 94 basis point decrease in our cost of interest bearing funds. 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. 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 a stable net interest margin in the near term as we do not expect interest rates to rise in the near future, we do not expect significant growth in our interest earning assets, nor do we expect our nonperforming asset balances to decline significantly in the near future. We continue to monitor the net interest margin through net interest income simulation to minimize the potential for any significant negative impact. See the Market Risk Management section for further discussion of the impact changes in market interest rates could have on us.

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

			2008			2007			2006
	Average Balances	Earnings/ Expense	Yield/ Rate	Average Balances	Earnings/ Expense	Yield/ Rate	Average Balances	Earnings/ Expense	Yield/ Rate
Dollars in thousands									
ASSETS									
Interest earning assets									
Loans, net of unearned interest (1)									
Taxable	$1,127,808	$77,055	6.83%	$963,116	$77,511	8.05%	$872,017	$68,915	7.90%
Tax-exempt (2)	8,528	697	8.17%	9,270	738	7.96%	8,428	642	7.62%
Securities									
Taxable	264,667	13,707	5.18%	219,605	11,223	5.11%	193,046	9,403	4.87%
Tax-exempt (2)	49,953	3,380	6.77%	47,645	3,289	6.90%	46,382	3,227	6.96%
Federal Funds sold and interest bearing deposits with other banks	370	8	2.16%	1,011	51	5.04%	1,216	62	5.10%
	$1,451,326	$94,847	6.54%	$1,240,647	$92,812	7.48%	$1,121,089	$82,249	7.34%
Noninterest earning assets									
Cash and due from banks	18,792			14,104			13,417		
Banks premises and equipment	22,154			22,179			23,496		
Other assets	38,760			30,795			26,422		
Allowance for loan losses	(12,980)			(8,683)			(6,849)		
Total assets	$1,518,052			$1,299,042			$1,177,575		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Liabilities									
Interest bearing liabilities									
Interest bearing demand deposits	$190,066	$2,416	1.27%	$227,014	$7,695	3.39%	$215,642	$7,476	3.47%
Savings deposits	55,554	908	1.63%	42,254	706	1.67%	42,332	554	1.31%
Time deposits	568,491	24,019	4.23%	524,389	25,895	4.94%	458,864	20,282	4.42%
Short-term borrowings	112,383	2,392	2.13%	95,437	4,822	5.05%	130,771	6,612	5.06%

Long-term borrowings and subordinated debentures	419,454	19,674	4.69%	245,937	13,199	5.37%	176,422	9,455	5.36%
	$1,345,948	$49,409	3.67%	$1,135,031	$52,317	4.61%	$1,024,031	$44,379	4.33%
Noninterest bearing liabilities									
Demand deposits	75,165			65,060			64,380		
Other liabilities	7,976			11,000			10,106		
Total liabilities	1,429,089			1,211,091			1,098,517		
Shareholders' equity	88,963			87,951			79,058		
Total liabilities and shareholders' equity	$1,518,052			$1,299,042			$1,177,575		
NET INTEREST EARNINGS		$45,438			$40,495			$37,870	
NET INTEREST MARGIN			3.13%			3.26%			3.38%

(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 $775,000, $633,000, and $636,000 for the years ended December 31, 2008, 2007 and 2006 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 $1,363,000, $1,428,000, and $1,286,000.

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

	2008 Versus 2007 Increase (Decrease) Due to Change in:			2007 Versus 2006 Increase (Decrease) Due to Change in:		
Dollars in thousands	Volume	Rate	Net	Volume	Rate	Net
Interest earned on:						
Loans						
Taxable	$ 12,191	$ (12,647)	$ (456)	$ 7,312	$ 1,284	$ 8,596
Tax-exempt	(60)	19	(41)	66	30	96
Securities						
Taxable	2,332	152	2,484	1,341	479	1,820
Tax-exempt	157	(66)	91	87	(25)	62
Federal funds sold and interest bearing deposits with other banks	(22)	(21)	(43)	(10)	(1)	(11)
Total interest earned on interest earning assets	14,598	(12,563)	2,035	8,796	1,767	10,563
Interest paid on:						
Interest bearing demand deposits	(1,090)	(4,189)	(5,279)	388	(169)	219
Savings deposits	217	(15)	202	(1)	153	152
Time deposits	2,062	(3,938)	(1,876)	3,082	2,531	5,613
Short-term borrowings	740	(3,170)	(2,430)	(1,786)	(4)	(1,790)
Long-term borrowings and subordinated debentures	8,316	(1,841)	6,475	3,731	13	3,744
Total interest paid on interest bearing liabilities	10,245	(13,153)	(2,908)	5,414	2,524	7,938
Net interest income	$ 4,353	$ 590	$ 4,943	$ 3,382	$ (757)	$ 2,625

Noninterest Income

Noninterest income from continuing operations totaled 0.19%, 0.57%, and 0.31%, of average assets in 2008, 2007 and 2006 respectively. Noninterest income from continuing operations totaled $2,868,000 in 2008, compared to $7,357,000 in 2007 and $3,633,000 in 2006, with service fees from deposit accounts and insurance commissions being the primary positive components. During 2008, we recorded an other-than-temporary impairment charge on securities of $7,060,000. Further detail regarding noninterest income from continuing operations is reflected in the following table.

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Noninterest Income - Continuing Operations						
Dollars in thousands		2008		2007		2006
Insurance commissions	$	5,139	$	2,876	$	924
Service fees		3,246		3,004		2,758
Securities (losses)		(6)		-		-
Other-than-temporary impairment of securities		(7,060)		-		-
Net cash settlement on interest rate swaps		(170)		(727)		(534)
Change in fair value of interest rate swaps		705		1,478		(90)
Gain (loss) on sale of assets		126		(33)		(46)
Other		888		759		622
Total	$	2,868	$	7,357	$	3,634

Insurance commissions: The increase in both 2008 and 2007 are due to our acquisition of the Kelly Agencies, two insurance agencies specializing in group health, life and disability benefit plans in July, 2007.

Service fees: Total service fees increased 8.1% in 2008 and 8.9% in 2007 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 during 2007.

Other-than-temporary impairment of securities: During 2008, we took an other-than-temporary non-cash impairment charge of $6.4 million pre-tax, equivalent to $4.0 million after-tax, related to $8.0 million of certain preferred stock issuances of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation and a $0.7 million impairment charge on our investment in Greater Atlantic Financial Corp.'s common stock .

Change in fair value of derivative instruments: During 2008, we realized a $705,000 gain on derivative instruments upon termination of interest rate swaps that did not qualify for hedge accounting. During 2007, $1,478,000 change in fair value was attributable to the expectation of falling short-term market interest rates which positively impacts the fair value of related derivative instruments.

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

Noninterest Expense

Noninterest expense for continuing operations was well controlled in both 2008 and 2007. These expenses totaled $29,434,000, $25,098,000 and $21,609,000, or 1.9%, 1.9%, and 1.8% of average assets for each of the years ended December 31, 2008, 2007 and 2006, respectively. Total noninterest expense for continuing operations increased $4,336,000 in 2008 compared to 2007, and $3,489,000 in 2007 compared to 2006. Table III below shows the breakdown of these increases.

Salaries and employee benefits: Salaries and employee benefits increased 14.7% during 2008 compared to 2007. The additional salaries and benefit costs associated with the Kelly Agencies was generally offset by reductions in performance-based incentive payments throughout the Company. These expenses increased 23.6% in 2007 primarily due to increased staffing as a result of the acquisition of the Kelly Agencies.

Net occupancy and Equipment expense: The increases in net occupancy and equipment expense for 2008 and 2007 are attributed to increased facility costs as a result of acquiring the Kelly Agencies in 2007.

Other: Other expenses increased $1,701,000 or 36.7% during 2008. The two largest contributors to this increase were 1) FDIC assessment, which totaled $744,000 in 2008 compared to $290,000 in 2007 due to an increase in assessment rates by the FDIC and 2) $681,000 of expenses related to the termination during 2008 of the merger agreement with Greater Atlantic Financial Corp.

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Table III - Noninterest Expense - Continuing Operations

Dollars in thousands	2008	Change $	Change %	2007	Change $	Change %	2006
Salaries and employee benefits	$ 16,762	$ 2,154	14.7%	$ 14,608	$ 2,787	23.6%	$ 11,821
Net occupancy expense	1,870	112	6.4%	1,758	201	12.9%	1,557
Equipment expense	2,173	169	8.4%	2,004	103	5.4%	1,901
Supplies	925	54	6.2%	871	74	9.3%	797
Professional fees	723	28	4.0%	695	(198)	-22.2%	893
Advertising	289	18	6.6%	271	(13)	-4.6%	284
Amortization of intangibles	351	100	39.8%	251	100	66.2%	151
Other	6,341	1,701	36.7%	4,640	434	10.3%	4,206
Total	$ 29,434	$ 4,336	17.3%	$ 25,098	$ 3,488	16.1%	$ 21,610

Income Tax Expense/Benefit

Income tax expense/benefit for continuing operations for the three years ended December 31, 2008, 2007 and 2006 totaled ($291,000), $5,734,000, and $5,018,000, respectively. Refer to Note 14 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 2008 were $1,518,052,000, an increase of 16.9% over 2007's average of $1,299,042,000. Average assets grew 10.3% in 2007, from $1,177,575,000 in 2006. This growth principally occurred in our loan portfolio in both years. Significant changes in the components of our balance sheet in 2008 and 2007 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

	2008	2007	2006	2005	2004

Dollars in thousands	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Commercial	$ 130,106	10.7%	$ 92,599	8.7%	$ 69,470	7.5%	$ 63,206	7.9%	$ 53,226	8.7%
Commercial real estate, land development, and construction	667,729	55.2%	609,748	57.4%	530,018	57.3%	407,435	50.8%	283,547	46.6%
Residential mortgage	376,026	31.0%	322,640	30.3%	282,512	30.5%	285,241	35.6%	223,690	36.7%
Consumer	31,519	2.6%	31,956	3.0%	36,455	3.9%	36,863	4.6%	38,948	6.4%
Other	6,061	0.5%	6,641	0.6%	6,969	0.8%	8,598	1.1%	9,605	1.6%
Total loans	$ 1,211,441	100.0%	$ 1,063,584	100.0%	$ 925,424	100.0%	$ 801,343	100.0%	$ 609,016	100.0%

Total net loans averaged $1,136,336,000 in 2008 compared to $972,386,000 in 2007, which represented 74.9% of total average assets for both years. The increase in the dollar volume of loans was primarily attributable to our growth mode. This trend will not continue due to the current weakened economic conditions in our market areas and limited availability of new capital resources.

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Refer to Note 7 of the accompanying consolidated financial statements for our loan maturities and a discussion of our adjustable rate loans as of December 31, 2008.

In the normal course of business, we make various commitments and incur certain contingent liabilities, which are disclosed in Note 16 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 21.6% of total assets at December 31, 2008 compared to 20.9% at December 31, 2007. Average securities approximated $314,620,000 for 2008 or 17.7% more than 2007's average of $267,250,000. Refer to Note 6 of the accompanying consolidated financial statements for details of amortized cost, the estimated fair values, unrealized gains and losses as well as the security classifications by type.

All of our securities are classified as available for sale to provide us with flexibility to better manage our balance sheet structure and react to asset/liability management issues as they arise. Pursuant to 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 2008, we took an other-than-temporary non-cash impairment charge of $6.4 million pre-tax, equivalent to $4.0 million after-tax, related to $8.0 million of certain preferred stock issuances of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation that we continue to own with a book value of $103,000. The action taken by the Federal Housing Finance Agency on September 7, 2008 placing these Government-Sponsored Agencies into conservatorship and eliminating the dividends on their preferred shares led to our determination that these securities are other-than-temporarily impaired. We also recognized an other-than-temporary impairment charge of $0.7 million (the entire amount) on our investment in Greater Atlantic Financial Corp. stock, which we continue to own.

At December 31, 2008 we had $10.0 million in unrealized losses related to residential mortgage backed securities issued by nongovernment sponsored entities. We monitor the performance of the mortgages underlying these bonds. Although there has been some deterioration in collateral performance, we only hold the most 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 credit markets and not to deterioration in credit quality. We expect to receive all contractual principal and interest payments due on our debt securities and have the ability and intent to hold these investments until their fair value recovers or until maturity. The mortgages in these asset pools have been made to borrowers with strong credit history and significant equity invested in their homes. They are well diversified geographically. Nonetheless, significant further weakening of economic fundamentals coupled with significant increases in unemployment and substantial deterioration in the value of high end residential properties could extend distress to this borrower population. This could increase default rates and put additional pressure on property values. Should these conditions occur, the value of these securities could decline and trigger the recognition of an other-than-temporary impairment charge.

At December 31, 2008, 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, 2008, 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.

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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	
U. S. Government agencies and corporations	$ 3,741	4.5%	$ 8,769	4.9%	$ 17,453	5.1%	$ 6,971	5.4%
Residential mortgage backed securities:								
Government sponsored agencies	52,645	5.3%	56,858	5.3%	25,799	5.6%	11,773	5.7%
Nongovernment sponsored entities	15,793	6.3%	47,657	6.5%	22,884	6.2%	9,234	5.6%
State and political subdivisions	776	4.2%	6,176	6.6%	12,978	6.7%	30,447	6.5%
Corporate debt securities	-	-	349	6.8%	-	-	-	-
Other	-	-	-	-	-	-	395	-
Total	$ 72,955	5.5%	$ 119,809	5.8%	$ 79,114	5.9%	$ 58,820	6.0%

Deposits

Total deposits at December 31, 2008 increased $137,163,000 or 16.6% compared to December 31, 2007. Average interest bearing deposits increased $20,454,000, or 2.6% during 2008. We have strengthened our focus on growing retail deposits, which is reflected by their steady growth over the past two years, increasing 2.6% in 2008 and 7.1% in 2007. Wholesale deposits, which represent brokered certificates of deposit acquired through a third party, increased 68.1% to $296,589,000 at December 31, 2008. These deposits totaled $176,391,000 at December 31, 2007, a decrease of 36.9% from 2006. During 2008, 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. Our decreased utilization of brokered deposits during 2007 was due to favorable pricing of other alternative wholesale funding sources, including wholesale reverse repurchase agreements.

Deposits Dollars in thousands	2008	2007	2006	2005	2004

Noninterest bearing demand	$ 69,808	$ 65,727	$ 62,591	$ 62,617	$ 55,402
Interest bearing demand	156,990	222,825	220,167	200,638	122,355
Savings	61,689	40,845	47,984	44,681	50,428
Certificates of deposit	347,444	291,294	249,952	211,032	217,863
Individual Retirement Accounts	33,330	31,605	28,370	26,231	25,298
Retail deposits	669,261	652,296	609,064	545,199	471,346
Wholesale deposits	296,589	176,391	279,623	128,688	53,268
Total deposits	$ 965,850	$ 828,687	$ 888,687	$ 673,887	$ 524,614

See Table I for average deposit balance and rate information by deposit type for 2008, 2007 and 2006 and Note 12 of the accompanying consolidated financial statements for a maturity distribution of time deposits as of December 31, 2008.

Borrowings

Lines of Credit: We have available lines of credit from various correspondent banks totaling $18,501,000 at December 31, 2008. 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 $188,279,000 at December 31, 2008. 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, 2008, which is primarily secured by consumer loans.

Short-term Borrowings: Total short-term borrowings decreased $18,955,000 from $172,055,000 at December 31, 2007 to $153,100,000 at December 31, 2008. These borrowings were principally replaced with brokered certificates of deposits. See Note 13 of the accompanying consolidated financial statements for additional disclosures regarding our short-term borrowings.

Long-term Borrowings: Total long-term borrowings of $392,748,000 at December 31, 2008, 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 $65,123,000 to $260,111,000 compared to the $194,988,000 outstanding at December 31, 2007. We have a term loan with an unrelated financial institution that is secured by the common stock of our subsidiary bank, with an interest rate of prime minus 50 basis points, and matures in 2017. The outstanding balance of this term loan was $12,637,000 and $10,750,000 at December 31, 2008 and 2007, respectively. During 2008, $10 million of subordinated debt was issued to an unrelated institution, which bears a variable interest rate of 1 month LIBOR plus 275 basis points, a term of 7.5 years, and it is not prepayable by us within the first two and one half years. During 2007, we entered into $110 million of structured reverse repurchase agreements, with terms ranging from 5 to 10 years and call features ranging from 2 to 3.5 years in which they are callable by the purchaser. Long term borrowings were principally used to fund our loan growth. Refer to Note 13 of the accompanying consolidated financial statements for additional information regarding our long-term borrowings.

ASSET QUALITY

During 2007, certain of our customers began experiencing difficulty making timely payments on their loans. Due to current declining economic conditions, borrowers have in many cases been unable to refinance their loans due to a range of factors including declining property values. As a result, we have experienced higher delinquencies and nonperforming assets, particularly 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. While management anticipates loan delinquencies will remain higher than historical levels for the foreseeable future, we anticipate that nonperforming assets will remain elevated in the near term.

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

Table VI - Nonperforming Assets

Dollars in thousands	2008	2007	2006	2005	2004
Nonaccrual loans	$ 46,930	$ 2,917	$ 638	$ 583	$ 532
Accruing loans past due					
90 days or more	1,039	7,416	4,638	799	140
Total nonperforming loans	47,969	10,333	5,276	1,382	672

Foreclosed properties and repossessed assets	8,113	2,058	77	285	646
Nonaccrual securities	-	-	-	-	349
Total nonperforming assets	$ 56,082	$ 12,391	$ 5,353	$ 1,667	$ 1,667
Total nonperforming loans as a percentage of total loans	3.97%	0.97%	0.57%	0.17%	0.11%
Total nonperforming assets as a percentage of total assets	3.45%	0.86%	0.43%	0.15%	0.19%

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

Loans Past Due 30-89 Days

Dollars in thousands	12/31/2008	12/31/2007
Commercial	$ 114	$ 264
Commercial real estate	195	1,604
Construction and development	2,722	997
Residential real estate	5,009	4,485
Consumer	824	1,335
Total	$ 8,864	$ 8,685

Total nonaccrual loans and accruing loans past due 90 days or more increased from $10,333,000 at December 31, 2007 to $47,969,000 at December 31, 2008. The following table shows our nonperforming loans by category as of December 31, 2008 and 2007.

Nonperforming Loans by Type

Dollars in thousands	2008	2007
Commercial	$ 199	$ 716
Commercial real estate	24,323	4,346
Land development and construction	18,382	2,016
Residential real estate	4,986	3,012
Consumer	79	243
Total	$ 47,969	$ 10,333

Commercial real estate nonperforming: One borrower -- a hotel, conference and golf course facility near Front Royal, Virginia -- comprises 98% of the balance of nonperforming commercial real estate loans at December 31, 2008. The debtor has filed for bankruptcy reorganization, and we expect this problem credit to be resolved within the next 12 months.

Land development and construction nonperforming: Approximately 82% of our nonperforming land development and construction loans are comprised of three credits related to residential development projects, as follows:

Description	Location	Balance (in millions)
Residential lots	Front Royal, VA	$ 2.2
Residential subdivision and acreage	Berkeley County, WV	3.4
Residential subdivision	Berkeley County, WV	9.5

Residential real estate nonperforming: Nonperforming residential real estate loans increased during 2008 as many borrowers have been unable to make their payments due to a range of factors stemming from current recessionary economic conditions.

All nonperforming loans are individually reviewed and adequate reserves are in place. The majority of nonperforming loans are secured by real property with values supported by appraisals. Refer to Note 8 of the accompanying consolidated financial statements for a discussion of impaired loans which are included in the above balances.

As a result of our internal loan review process, the ratio of internally classified loans to total loans increased from 6.20% at December 31, 2007 to 9.18% at December 31, 2008. 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 collectibility, 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 increase in internally classified loans at December 31, 2008 occurred throughout our portfolios of real estate related loans, as shown in the table below, as several of these loans have been downgraded by management as they fell outside of our internal lending policy guidelines, became past due or were placed on nonaccrual status.

Internally Classified Loans

	Balance at December 31,	
Dollars in thousands	2008	2007
Commerical	$ 984	$ 1,754
Commercial real estate	30,435	10,987
Land development & construction	60,589	41,906
Residential real estate	18,405	10,783
Consumer	633	539
Total	$ 111,046	$ 65,969

Included in the net balance of loans are nonaccrual loans amounting to $46,930,000 and $2,917,000 at December 31, 2008 and 2007, respectively. If these loans had been on accrual status throughout 2008, the amount of interest income that we would have recognized would have been $3,110,000. The actual amount of interest income recognized in 2008 on these loans was $1,181,000.

In addition to nonperforming loans discussed above, we have also identified approximately $40 million of potential problem loans at December 31, 2008 related to 9 relationships. These potential problem loans are loans that were performing at December 31, 2008, 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 losses that can be reasonably anticipated. We conduct quarterly evaluations of our loan portfolio to determine its adequacy. In assessing the adequacy of our allowance for loan losses, we conduct a two part evaluation. First, we specifically identify loans that have weaknesses that have been identified, using the fair value of collateral method. Second, we stratify the loan portfolio into 6 homogeneous loan pools, including commercial real estate, other commercial, residential real estate, autos, and others. Historical loss rates, as adjusted, are applied against the then outstanding balance of loans in each classification to estimate probable losses inherent in each segment of the portfolio. Historical loss rates are adjusted using potential risk factors that could result in actual losses deviating from prior loss experience. Such 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. In addition, we conduct comprehensive, ongoing reviews of our loan portfolio, which encompasses the identification of all potential problem credits to be included on an internally generated watch list.

The identification of loans for inclusion on the watch list of loans that have been specifically identified is facilitated 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 list is reviewed to ensure it is complete, we review the specific loans for collectibility, 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. Based on the results of these reviews, specific reserves for potential losses are identified and the allowance for loan losses is adjusted appropriately through a provision for loan losses.

The allocated portion of the allowance for loan losses is established on a loan-by-loan and pool-by-pool basis. The unallocated portion is for inherent losses that probably exist as of the evaluation date, but which have not been specifically identified by the processes used to establish the allocated portion due to inherent imprecision in the objective processes we utilize to identify probable and estimable losses. This unallocated portion is subjective and requires judgment based on various qualitative factors in the loan portfolio and the market in which we operate. The entire allowance for loan losses was allocated at December 31, 2008 and 2007. At December 31, 2006, the unallocated portion of the allowance approximated $120,000 or 1.6% of the total allowance. This unallocated portion of the allowance is considered necessary based on consideration of the known risk elements in certain pools of loans in the loan portfolio and our assessment of the economic environment in which we operate. More specifically, while loan quality remains good, the subsidiary bank has typically experienced greater losses within certain homogeneous loan pools when our market area has experienced economic downturns or other significant negative factors or trends, such as increases in bankruptcies, unemployment rates or past due loans.

At December 31, 2008 and 2007, our allowance for loan losses totaled $16,933,000, or 1.40% of total loans and $9,192,000, or 0.86% of total loans, respectively, and is considered adequate to cover inherent losses in our loan portfolio. Table VII presents an allocation of the allowance for loan losses by loan type at each respective year end date, as follows:

Table VII - Allocation of the Allowance for Loan Losses

	2008		2007		2006		2005		2004	
Dollars in thousands	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans	Amount	% of loans in each category to total loans
Commercial	$ 546	10.7%	$ 543	8.7%	$ 367	7.5%	$ 270	7.9%	$ 187	8.7%
Commercial real estate, land development, and construction	12,241	55.2%	5,922	57.3%	5,209	57.3%	4,232	50.8%	2,462	46.6%
Residential real estate	3,458	31.0%	1,991	30.4%	1,057	30.5%	979	35.6%	1,376	36.7%
Consumer	427	2.6%	451	3.0%	561	3.9%	580	4.6%	1,016	6.4%
Other	261	0.5%	285	0.6%	197	0.8%	47	1.1%	-	1.6%
Unallocated	-	-	-	-	120	-	4	-	32	-
	$ 16,933	100.0%	$ 9,192	100.0%	$ 7,511	100.0%	$ 6,112	100.0%	$ 5,073	100.0%

At December 31, 2008, we had approximately $8,113,000 in other real estate owned which was obtained as the result of foreclosure proceedings. Although foreclosures have increased during 2008, we do not anticipate any significant losses on the property currently held in other real estate owned.

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

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TABLE VIII - ALLOWANCE FOR LOAN LOSSES

Dollars in thousands	2008	2007	2006	2005	2004
Balance, beginning of year	$ 9,192	$ 7,511	$ 6,112	$ 5,073	$ 4,681
Losses:					
Commercial	198	50	32	36	142
Commercial real estate	1,131	154	185	-	336
Construction and development	4,529	80			
Real estate - mortgage	1,608	618	35	60	5
Consumer	375	216	200	173	208
Other	203	160	289	364	286
Total	8,044	1,278	741	633	977
Recoveries:					
Commercial	4	2	1	6	19
Commercial real estate	17	13	46	41	27
Construction and development	-	20	-	-	-
Real estate - mortgage	64	15	7	-	9
Consumer	72	58	62	56	109
Other	128	104	179	274	155
Total	285	212	295	377	319
Net losses	7,759	1,066	446	256	658
Provision for loan losses	15,500	2,055	1,845	1,295	1,050
Reclassification of reserves related to loans previously reflected in discontinued operations	-	692	-	-	-
Balance, end of year	$ 16,933	$ 9,192	$ 7,511	$ 6,112	$ 5,073

LIQUIDITY AND CAPITAL RESOURCES

Bank Liquidity: Liquidity reflects our ability to ensure the availability of adequate funds to meet loan commitments and deposit withdrawals, as well as provide for other transactional requirements. Liquidity is provided primarily by funds invested in cash and due from banks (net of float and reserves), Federal funds sold, non-pledged securities, and available lines of credit with the Federal Home Loan Bank, which totaled approximately $174,167,000 or 10.7% of total consolidated assets at December 31, 2008.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit activity. Core deposits increased $17 million in 2008, while loans increased approximately $147 million. This caused us to rely on other wholesale funding vehicles, primarily brokered deposits to fund loan growth. As a member of the Federal Home Loan Bank of Pittsburgh, we have access to approximately $591 million. As of December 31, 2008 and 2007, these advances totaled approximately $402 million and $354 million, respectively. At December 31, 2008, we had additional borrowing capacity of $188 million through FHLB programs. We also have the ability to borrow money on a daily basis through correspondent banks using established federal funds purchased lines. These available lines totaled $18.5 million at December 31, 2008. We also have established a line with the Federal Reserve Bank to be used as a contingency liquidity vehicle. The amount available on this line at December 31, 2008 was approximately $23 million, which is secured by a pledge of our consumer loan portfolio. In early March 2009, we expanded this line by pledging our commercial and industrial loans, increasing our total availability to $116 million. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises.

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

Growth and Expansion: During 2008, we spent approximately $1.9 million on capital expenditures for premises and equipment. We expect our capital expenditures to approximate $2 million in 2009, primarily for building construction, furniture

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and equipment related to a new banking office presently under construction in Leesburg, Virginia.

Management anticipates that the Company's near term growth in assets to be very nominal in comparison with that of recent prior years due to the present recessionary economic environment and our limited excess capital resources.

Capital Compliance: Our capital position has tightened as a result of our continued growth and the significant reductions in our earnings over the past two years. Stated as a percentage of total assets, our equity ratio was 5.4% and 6.2% at December 31, 2008 and 2007, respectively. At December 31, 2008, Summit's parent holding company had Tier 1 risk-based, Total risk-based and Tier 1 leverage capital in excess of the minimum levels required to be considered "well capitalized" of $24.7 million, $0.5 million, and $20.0 million, respectively. Our subsidiary bank, Summit Community Bank, had Tier 1 risk-based, Total risk-based and Tier 1 leverage capital in excess of the minimum "well capitalized" levels of $39.4 million, $5.3 million, $35.3 million, respectively. We intend to maintain both Summit's and its subsidiary bank's capital ratios at levels that would be considered to be "well capitalized" in accordance with regulatory capital guidelines. See Note 17 of the accompanying consolidated financial statements for further discussion of our regulatory capital.

During first quarter 2008, we issued $10 million of subordinated debentures which qualifies as Tier 2 capital. This debt has an interest rate of 1 month LIBOR plus 275 basis points, a term of 7.5 years, and is not prepayable by us within the first two and a half years. In addition, we are presently considering and evaluating the possibility of raising additional capital, including the issuance of convertible preferred stock and additional subordinated debentures.

Stock Repurchases: In August 2006, our Board of Directors authorized the open market repurchase of up to 225,000 shares (approximately 3%) of the issued and outstanding shares of our stock. During 2008, we did not repurchase any shares under this plan, and no further share repurchases are presently contemplated.

Issuance of Trust Preferred Securities: Under Federal Reserve Board guidelines, we had the ability to issue an additional $6.3 million of trust preferred securities as of December 31, 2008 that would qualify as Tier 1 regulatory capital to support our future growth. Trust preferred securities issuances in excess of this limit generally may be included in Tier 2 capital.

Dividends: Cash dividends per share were $0.36 and $0.34 in 2008 and 2007, respectively, representing dividend payout ratios of 116.0% and 38.1% for 2008 and 2007, respectively. Future cash dividends will depend on the earnings,and financial condition of our subsidiary bank and our capital adequacy as well as general economic conditions.

The primary source of funds for the dividends paid to our shareholders is dividends received from our subsidiary bank. Dividends paid by our subsidiary bank are subject to restrictions by banking regulations. The most restrictive provision requires approval by the bank's regulatory agency if dividends declared in any year exceed the bank's current year's net income, as defined, plus its retained net profits of the two preceding years. During 2009, the net retained profits available for distribution to Summit as dividends without regulatory approval are approximately $15,039,000, plus net income for the interim periods through the date of declaration.

Legal Contingencies: We are involved in various legal actions arising in the ordinary course of business. In the opinion of counsel, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements. Refer to Note 16 of the accompanying consolidated financial statements for a discussion of our current litigation.

Contractual Cash Obligations: During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at December 31, 2008. The operating lease obligations include leases for both continuing and discontinued operations, as we remain obligated to pay the lease until mid-2009 of one property that was used by Summit Mortgage.

Dollars in thousands	Long Term Debt and Subordinated Debentures	Operating Leases
2009	$ 83,911	$ 632
2010	76,481	228
2011	32,459	148
2012	64,915	149
2013	40,080	119
Thereafter	114,491	22
Total	$ 412,337	$ 1,298

Off-Balance Sheet Arrangements: We are involved with some off-balance sheet arrangements that have or are reasonably likely to have an effect on our financial condition, liquidity, or capital. These arrangements at December 31, 2008 are presented in the following table. Refer to Note 16 of the accompanying consolidated financial statements for further discussion of our off-balance sheet arrangements.

Commitments to extend credit:	
Dollars in thousands	
Revolving home equity and credit card lines	$ 45,097
Construction loans	65,271
Other loans	42,191
Standby letters of credit	10,584
Total	$ 163,143

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

MARKET RISK MANAGEMENT

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

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. At December 31, 2008, our interest rate risk position was liability sensitive. That is, liabilities are likely to reprice faster than assets, resulting in a decrease in net interest income in a rising rate environment, while a falling interest rate environment would produce an increase in net interest income. Net interest income is also subject to changes in the shape of the yield curve. In general, a flat yield curve results in a decline in our earnings due to the compression of earning asset yields and funding rates, while a steepening would result in increased earnings as margins widen.

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

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of December 31, 2008. 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) 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)	0.74%	2.77%
Up 100 (1)	-2.15%	-3.21%
Up 200 (1)	-4.16%	-6.57%

Up 200, flattening yield curve (2)	-4.32%	-3.27%

(1) assumes a parallel shift in the yield curve
(2) assumes flattening curve whereby short term rates increase by 200 basis points while long term rates increase soas to bear the same average relationship to short term rates that existed during 2005 thru 2007, the last extended period of a flat yield curve environment.

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

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

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

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

Management assessed the Corporation's system of internal control over financial reporting as of December 31, 2008. In making this assessment, we used the criteria for effective internal control over financial reporting set forth in Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concludes that, as of December 31, 2008, its system of internal control over financial reporting is effective and meets the criteria of the Internal Control-Integrated Framework. Arnett & Foster, P.L.L.C., independent registered public accounting firm, has issued an attestation report on management's assessment of the Corporation's internal control over financial reporting.

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

Mangagement assessed compliance with the designated laws and regulations relating to safety and soundness. Based on this assessment, management believes that Summit complied, in all significant respects, with the designated laws and regulations related to safety and soundness for the year ended December 31, 2008.

/s/ H. Charles Maddy, III /s/ Robert S.
Tissue /s/ Julie R. Cook
President and Senior Vice
President Vice President

Chief Executive Officer and Chief Financial Officer and Chief Accounting Officer

Moorefield, West Virginia
March 13, 2009

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

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

We have audited Summit Financial Group, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Summit Financial Group, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principals. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Summit Financial Group, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Summit Financial Group, Inc. and subsidiaries and our report dated March 13, 2009 expressed an unqualified opinion.

/s/ ARNETT & FOSTER, P.L.L.C.

Charleston, West Virginia
March 13, 2009

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Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the consolidated balance sheets of Summit Financial Group, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Summit Financial Group, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Summit Financial Group, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 13, 2009 expressed an unqualified opinion on the effectiveness of Summit's internal control over financial reporting.

/s/ ARNETT & FOSTER, P.L.L.C.

Charleston, West Virginia
March 13, 2009

Consolidated Balance Sheets

Dollars in thousands	December 31, 2008	2007
ASSETS		
Cash and due from banks	$ 11,356	$ 21,285
Interest bearing deposits with other banks	108	77
Federal funds sold	2	181
Securities available for sale	327,606	283,015
Other investments	23,016	17,051
Loan held for sale, net	978	1,377
Loans, net	1,192,157	1,052,489
Property held for sale, net	8,110	2,058
Premises and equipment, net	22,434	22,130
Accrued interest receivable	7,217	7,191
Intangible assets	9,704	10,055
Other assets	24,428	18,413
Assets related to discontinued operations	-	214
Total assets	$ 1,627,116	$ 1,435,536
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Non-interest bearing	$ 69,808	$ 65,727
Interest bearing	896,042	762,960