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

FORM 10-K

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

For the fiscal year ended December 31, 2017

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 (Address of principal executive offices)	26836 (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 Capital 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 whether the registrant has submitted electronically and posted on its Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this

chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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. ¨

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

Large accelerated filer o	Accelerated filer þ
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

Indicate 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 common equity held by non-affiliates of the registrant at June 30, 2017, was approximately $237,632,000. 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.

The number of shares of the Registrant’s Common Stock outstanding on February 28, 2018 was 12,465,496.

Documents Incorporated by Reference

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

Document	Part of Form 10-K into which document is incorporated
Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 16, 2018	Part III - Items 10, 11, 12, 13 and 14

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PART I.

Item 1. Business

Summit Financial Group, Inc. (“Company” or “Summit”) is a $2.13 billion financial holding company headquartered in Moorefield, West Virginia incorporated on March 5, 1987. We provide community banking services primarily in the Eastern Panhandle and Southern regions of West Virginia and the Northern, Shenandoah Valley and Southwestern regions of Virginia. We provide these services through our community bank subsidiary, Summit Community Bank (“Summit Community” or “Bank”). We also operate Summit Insurance Services, LLC in Moorefield, West Virginia and Leesburg, Virginia, which provides insurance brokerage services to individuals and businesses covering corporate and personal property and casualty insurance products, as well as group health and life insurance products and consulting services.

Community Banking

We provide a wide range of community banking services, including demand, savings and time deposits; commercial, real estate and consumer loans; trust and wealth management services; and cash management services. The deposits of 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 clients and specialized services tailored to meet our clients' needs. We 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. Banking, like most industries, is becoming more dependent on technology as a means of marketing to customers, including the Internet, which we also utilize. This 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 prudent approach to lending, are important factors in our success and growth.

All operational and support functions that are transparent to clients are centralized 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, deposit operations, 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, human resources administration 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.

Lending

Our primary lending focus is providing commercial loans to local businesses with annual sales generally 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 $10 million. We generally do not seek loans of more than $15 million but will consider larger lending relationships exhibiting above-average 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.

We segment our loan portfolio in to the following major lending categories: commercial, commercial real estate, construction and land development, residential real estate, consumer and mortgage warehouse lines of credit. Commercial loans are loans made to commercial borrowers that are not secured by real estate. These encompass loans secured by accounts receivable, inventory and equipment, as well as unsecured loans. Commercial real estate loans consist of commercial mortgages, which generally are secured by nonresidential and multi-family residential properties. Commercial real estate loans are made to many of the same customers and carry similar industry risks as the commercial loan portfolio. Construction and development loans are loans made for the purpose of financing construction or development projects. This portfolio includes commercial and residential land development loans, one-to-four family housing construction, both pre-sold and speculative in nature, multi-family housing construction, non-residential building construction and undeveloped land. Residential real estate loans are mortgage loans to consumers and are secured primarily by a first lien deed of trust. These loans are traditional one-to-four family residential mortgages. Also included in this category of loans are second liens on one-to-four family properties, commercial loans secured by one-to-four family residence and home equity loans. Consumer loans are loans that establish consumer credit that is granted for the consumer’s personal use. These loans include automobile loans and recreational vehicle

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loans, as well as personal secured and unsecured loans. Our mortgage warehouse lines of credit result solely from a participation arrangement with a regional bank to fund residential mortgage warehouse lines of medium- and large-sized mortgage originators located throughout the United States.

Our loan underwriting guidelines and standards are consistent with the prudent banking practices applicable to the relevant exposure and are updated periodically and presented to the Board of Directors for approval. The purpose of these standards and guidelines are: to grant loans on a sound and collectible basis; to invest available funds in a safe and profitable manner; to serve the legitimate credit needs of our primary market area; and to ensure that all loan applicants receive fair and equal treatment in the lending process. It is the intent of the underwriting guidelines and standards to: minimize losses by carefully investigating the credit history of each applicant; verify the source of repayment and the ability of the applicant to repay; collateralize those loans in which collateral is deemed to be required; exercise care in the documentation of the application, review, approval and origination process; and administer a comprehensive loan collection program.

Our real estate underwriting loan-to-value ("LTV") policy limits are at or below current bank regulatory guidelines, as follows:

	Regulatory LTV Guideline	Summit LTV Policy Limit
Undeveloped land	65%	65%
Land development	75%	70%
Land development - Finished building lots	85%	85%
Construction:		
Commercial, multifamily and other non-residential	80%	80%
1-4 family residential, consumer borrower	85%	85%
1-4 family residential, pre-sold commercial borrower	80%	80%
1-4 family residential, spec, commercial borrower	80%	70%
Improved property:		
Residential real estate - nonowner occupied	85%	85%
Commercial real estate - owner occupied	85%	85%
Commercial real estate - nonowner occupied	85%	85%
Owner occupied 1-4 family	90%	90%
Home equity	90%	90%

Exceptions are permitted to these regulatory guidelines as long as such exceptions are identified, monitored and reported to the Board of Directors at least quarterly and the total of such exceptions do not exceed 100% of Summit Community's total regulatory capital, which totaled $207.6 million as of December 31, 2017. As of this date, we had loans approximating $97.1 million which exceeded the above regulatory LTV guidelines, as follows:

Undeveloped land	$5.3	million
Land development	$1.7	million
Land development - Finished building lots	$—	
Construction:		
Commercial, multifamily and other non-residential	$0.3	million
1-4 family residential, consumer borrower	$—	
1-4 family residential, pre-sold, commercial borrower	$4.7	million
1-4 family residential, spec, commercial borrower	$3.8	million
Improved property:		
Residential real estate - nonowner occupied	$26.6	million
Commercial real estate - owner occupied	$23.6	million
Commercial real estate - nonowner occupied	$18.1	million

Owner occupied 1-4 family	$12.4 million
Home equity	$0.6 million

Our underwriting standards and practice are designed to originate both fixed and variable rate loan products, consistent with the underwriting guidelines discussed above. Adjustable rate and variable rate loans are underwritten, giving consideration both to the loan's initial rate and to higher assumed rates, commensurate with reasonably anticipated market conditions. Accordingly, we want to insure that adequate primary repayment capacity exists to address both future increases in interest rates and

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fluctuations in the underlying cash flows available for repayment. Historically, we have not offered “payment option ARM” loans. Further, we have had no loan portfolio products which were specifically designed for “sub-prime” borrowers (defined as consumers with a credit score of less than 599).

Supervision and Regulation

General

We are subject to regulation by the Board of Governors of the Federal Reserve System (“FRB”), the West Virginia Division of Financial Institutions, the Securities and Exchange Commission (the “SEC”) and other federal and state regulators. As a financial holding company, we are subject to the restrictions of the Bank Holding Company Act of 1956, as amended (“BHCA”), are registered pursuant to its provisions 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 and must submit annual reports to the West Virginia Division of Financial Institutions.

The BHCA prohibits the acquisition by a financial holding company of direct or indirect ownership of more than five percent (5%) 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 of more than five percent (5%) of the voting shares of any company that 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 ten percent (10%) or more of our 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.

The FRB has broad authority to prohibit activities of bank holding companies and their non-banking subsidiaries that represent unsafe and unsound banking practices or which constitute violations of laws or regulations. The FRB also can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as $1 million for each day the activity continues.

Summit Community, our only bank subsidiary, is subject to West Virginia banking statutes and regulations, and is primarily regulated by the West Virginia Division of Financial Institutions and the FDIC. The Bank is also subject to regulations promulgated by the FRB. As a member of the FDIC, Summit Community’s deposits 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, the Bank must furnish to regulatory authorities quarterly reports containing full and accurate statements of its affairs.

Because we are a public company, we are subject to regulation by the SEC. SEC regulations require us to disclose certain types of business and financial data on a regular basis to the SEC and to our shareholders. We are required to

file annual, quarterly and current reports with the SEC. We prepare and file an annual report on Form 10-K with the SEC that contains detailed financial and operating information, as well as a management response to specific questions about our operations. SEC regulations require that our annual reports to shareholders contain certified financial statements and other specific items such as management's discussion and analysis of our financial condition and results of operations. We must also file quarterly reports with the SEC on Form 10-Q that contain detailed financial and operating information for the prior quarter and we must file current reports on Form 8-K to provide the pubic with information on recent material events.

In addition to periodic reporting to the SEC, we are subject to proxy rules and tender offer rules issued by the SEC. Our officers, directors and principal shareholders (holding 10% or more of our stock) must also submit reports to the SEC regarding their holdings of our stock and any changes to such holdings and they are subject to short-swing profit liability. Because we are traded on the NASDAQ, we are also subject to the listing standards of NASDAQ.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

The "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act"), which is complex and broad in scope, established the Bureau of Consumer Financial Protection (the "CFPB"), which has extensive regulatory and enforcement powers over consumer financial products and services, and the Financial Stability Oversight Council, which has oversight authority for monitoring systemic risk. We will be required to comply with the Consumer Financial Protection Act and the CFPB's rules; however, these rules will be enforced by our primary regulator, the FRB, not the CFPB. In addition, the Dodd-Frank Act alters the authority and duties of the federal banking and securities regulatory agencies, implements certain corporate governance requirements for all public companies, including financial institutions with regard to executive compensation, proxy access by shareholders and certain whistleblower provisions and restricts certain proprietary trading and hedge fund and private equity activities of banks and their affiliates. Although the regulations that directly affect our business have been adopted, many of the provisions of the Dodd-Frank Act are subject to final rulemaking by the U.S. financial regulatory agencies and the implications of the Dodd-Frank Act for our business will depend to some extent on how such rules are adopted and implemented by the primary U.S. financial regulatory agencies.

Bank Holding Company Activities

In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. In addition, bank holding companies that qualify and elect to be financial holding companies may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity (as determined by the FRB in consultation with the Secretary of the Treasury) or (ii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally (as solely determined by the FRB), without prior approval of the FRB.

Activities that are financial in nature include securities underwriting and dealing, insurance underwriting and making merchant banking investments. 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 non-affiliated 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 non-affiliated persons in the execution and clearance on major commodity exchanges of futures contracts and options.

To maintain financial holding company status, a financial holding company and all of its depository institution subsidiaries must be "well capitalized" and "well managed." A depository institution subsidiary is considered to be "well capitalized" if it satisfies the requirements for this status discussed in the section captioned "Capital Requirements" included elsewhere in this item. A depository institution subsidiary is considered "well managed" if it received a composite rating and management rating of at least "satisfactory" in its most recent examination. A financial holding

company's status will also depend upon it maintaining its status as "well capitalized" and "well managed' under applicable FRB regulations. If a financial holding company ceases to meet these capital and management requirements, the FRB's regulations provide that the financial holding company must enter into an agreement with the FRB to comply with all applicable capital and management requirements. Until the financial holding company returns to compliance, the FRB may impose limitations or conditions on the conduct of its activities and the company may not commence any of the broader financial activities permissible for financial holding companies or acquire a company engaged in such financial activities without prior approval of the FRB. If the company does not return to compliance within 180 days, the FRB may require divestiture of the holding company's depository institutions. Bank holding companies and banks must also be both well capitalized and well managed in order to acquire banks located outside their home state.

In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire a company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least “satisfactory” in its most recent examination under the Community Reinvestment Act. See the section captioned “Community Reinvestment Act” included elsewhere in this item.

The FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or such ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

The Dodd-Frank Act amends the BHC Act to require the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the “Volcker Rule”. The Volcker Rule has not had a material impact on our operations as we do not generally engage in activities prohibited by the Volcker Rule.

The BHC Act, the Bank Merger Act, the West Virginia Banking Code and other federal and state statutes regulate acquisitions of commercial banks. The BHC Act requires the prior approval of the FRB for the direct or indirect acquisition by a bank holding company of more than 5.0% of the voting shares of a commercial bank or its parent holding company. Under the Bank Merger Act, the prior approval of the FRB or other appropriate bank regulatory authority is required for a member bank to merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant’s performance record under the Community Reinvestment Act (see the section captioned “Community Reinvestment Act” included elsewhere in this item) and its compliance with fair housing and other consumer protection laws and the effectiveness of the subject organizations in combating money laundering activities.

Dividends

The principal source of our liquidity is dividends from Summit Community. The prior approval of the Federal Reserve is required if the total of all dividends declared by a state-chartered member bank in any calendar year would exceed the sum of the bank’s net profits for that year and its retained net profits for the preceding two calendar years, less any required transfers to surplus or to fund the retirement of preferred stock. Federal law also prohibits a state-chartered, member bank from paying dividends that would be greater than the bank’s undivided profits. Summit Community is also subject to limitations under West Virginia state law regarding the level of dividends that may be paid.

In addition, the Company and Summit Community are subject to other regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The appropriate federal regulatory authority is authorized to determine under certain circumstances relating to the financial condition of a bank holding company or a bank that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. The appropriate federal regulatory authorities have stated that paying dividends that deplete a bank’s capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings.

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.

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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.

Capital Requirements

As a financial holding company, we are subject to FRB risk-based capital guidelines. In general, 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. Summit Community is subject to substantially similar capital requirements adopted by the FDIC. 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.

Under the requirements, banking organizations are required to maintain minimum ratios for Tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization’s assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. A depository institution’s or holding company’s capital, in turn, is classified in one of two tiers, depending on type:

- Core Capital (Tier 1). Tier 1 capital includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, minority interests in equity accounts of consolidated subsidiaries (and, under existing standards, a limited amount of qualifying trust preferred securities and qualifying cumulative perpetual preferred stock at the holding company level), less goodwill, most intangible assets and certain other assets.

- Supplementary Capital (Tier 2). Tier 2 capital includes, among other things, perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, qualifying mandatory convertible debt securities, qualifying subordinated debt and allowances for loan and lease losses, subject to limitations.

In July 2013, the Company’s and Summit Community’s federal banking regulators published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee on Banking Supervision’s (the “Basel Committee”) December 2010 framework known as “Basel III” for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to financial holding companies and depository institutions, including the Company and Summit Community. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions’ regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions’ regulatory capital ratios and replace the existing risk-weighting approach, which was derived from the Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee’s 2004 “Basel II” capital accords. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies’ rules. The Basel III Capital Rules were effective for the Company and Summit Community on January 1, 2015 (subject to a phase-in period).

The Basel III Capital Rules, among other things, (i) introduced a new capital measure called "Common Equity Tier 1" ("CET1"), (ii) specified that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) defined CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expanded the scope of the deductions/adjustments as compared to existing regulations.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and Summit Community to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively

resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets (as compared to a current minimum leverage ratio of 3% for banking organizations that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority's risk-adjusted measure for market risk).

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will face regulatorily prescribed limitations on dividend payments, discretionary payments on tier 1 capital instruments, share buybacks and discretionary bonus payments to certain Company officers based on the amount of the shortfall.

Under the Basel III Capital Rules, the applicable minimum capital ratios inclusive of the phased-in conservation buffer effective as of January 1, 2018 are as follows:

- 6.375% CET1 to risk-weighted assets
- 7.875% Tier 1 capital to risk-weighted assets
- 9.875% Total capital to risk-weighted assets
- 4.0% Tier 1 capital to average assets (leverage ratio)

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Furthermore, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios under current capital standards. However, under the Basel III Capital Rules, the effects of certain accumulated other comprehensive items are not excluded; however, certain banking organizations, including the Company and Summit Community, were permitted to make a one-time permanent election to continue to exclude these items. The Company and Summit Community made this election in order to minimize variations in the level of capital.

The Basel III Capital Rules also preclude certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies, subject to phase-out. However, for holding companies of depository institutions with less than $15 billion in consolidated total assets as of December 31, 2009, the rules do not require a phase out of trust preferred securities issued prior to May 19, 2010. This means that all of our trust preferred securities are permanently grandfathered as Tier 1 capital instruments.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

With respect to Summit Community, the Basel III Capital Rules also revise the "prompt corrective action" regulations pursuant to Section 38 of the Federal Deposit Insurance Act, as discussed below under "Prompt Corrective Action."

The Basel III Capital Rules prescribe a standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more

risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures and resulting in higher risk weights for a variety of asset categories. Specific changes to current rules impacting our determination of risk-weighted assets include, among other things:

- Applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans.
- Assigning a 150% risk weight to exposures (other than residential mortgage exposures) that are 90 days past due.
- Providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%).
- Providing for a risk weight, generally not less than 20% with certain exceptions, for securities lending transactions based on the risk weight category of the underlying collateral securing the transaction.

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In addition, the Basel III Capital Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

The Basel III Capital Rules continue to apply the previously applicable risk-based standard for residential mortgage loans which includes a 50% risk-weight for prudently underwritten first-lien mortgages that are not past due.

Our regulatory capital ratios and Summit Community's capital ratios as of year end 2017 are set forth in the table in Note 19 of the notes to the consolidated financial statements beginning on page 96. The Company and Summit Community Bank exceed all capital adequacy requirements, including applicable conservation buffers, under the Basel III Capital Rules as if such requirements were currently in effect on a fully phased-in basis.

Prompt Corrective Action. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("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. The relevant capital measures, which reflect changes under the Basel III Capital Rules, are the total capital ratio, the CET1 capital ratio, the Tier 1 capital ratio and the leverage ratio.

A bank will be (i) "well capitalized" if the institution has a total risk-based capital ratio of 10.0% or greater, a CET1 capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater and a leverage ratio of 5.0% or greater and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) "adequately capitalized" if the institution has a total risk-based capital ratio of 8.0% or greater, a CET1 capital ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater and a leverage ratio of 4.0% or greater and is not "well capitalized"; (iii) "undercapitalized" if the institution has a total risk-based capital ratio that is less than 8.0%, a CET1 capital ratio less than 4.5%, a Tier 1 risk-based capital ratio of less than 6.0% or a leverage ratio of less than 4.0%; (iv) "significantly undercapitalized" if the institution has a total risk-based capital ratio of less than 6.0%, a CET1 capital ratio less than 3.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%; and (v) "critically undercapitalized" if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes."

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 FRB (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 that 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.

In the most recent CRA examination by the bank regulatory authorities, Summit Community 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. 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 has as its "umbrella regulator" the FRB. Functional regulation of the financial holding company's separately regulated subsidiaries is 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 specifically gives the FRB the authority, by regulation or order, to expand the list of "financial" or "incidental" activities, but requires consultation with the U.S. Treasury Department, and gives the FRB authority to allow a financial holding company to engage in any activity that is "complementary" to a financial activity and does not "pose a substantial risk to the safety and soundness of depository institutions or the financial system generally."

Under the GLB Act, all financial institutions are required to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request and establish procedures and practices to protect customer data from unauthorized access. We have established policies and procedures to assure our compliance with all privacy provisions of the GLB Act. Pursuant to Title V of the GLB Act, we, like all other financial institutions, are required to:

- provide notice to our customers regarding privacy policies and practices,
- inform our customers regarding the conditions under which their non-public personal information may be disclosed to non-affiliated third parties and
- give our customers an option to prevent certain disclosure of such information to non-affiliated third parties.

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 Home Mortgage Disclosure Act and Regulation C, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair Debt Collection Act, the Right to Financial Privacy 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.

Dodd-Frank centralized responsibility for consumer financial protection by creating the CFPB and giving it responsibility for implementing, examining and enforcing compliance with federal consumer protection laws. The CFPB has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards. The CFPB's functions include investigating consumer complaints, rulemaking, supervising and examining banks' consumer transactions and enforcing rules related to consumer financial products and services including mortgage lending and servicing, fair lending requirements, and automotive finance. Summit Community Bank, as a bank with less than $10 billion in assets, is subject to these federal consumer financial laws, but continues to be examined for compliance by the FDIC, its primary federal banking regulator.

The CFPB has issued final regulations implementing provisions of the Dodd-Frank Act that require all creditors to determine a consumer's ability to repay a mortgage loan before making a loan. The final rule, referred to as the Ability-to Repay (ATR)/Qualified Mortgage (QM) standards, provide that a lender making a special type of loan, known as a Qualified Mortgage, is entitled to presume that the loan complies with the ATR safe harbor requirements. The rule establishes different types of Qualified Mortgages that are generally identified as loans with restrictions on loan features, limits on fees being charged and underwriting requirements.

USA Patriot Act of 2001

The USA Patriot Act of 2001 and its related regulations require insured depository institutions, broker-dealers and certain other financial institutions to have policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. The statute and its regulations also provide for information sharing, subject to conditions, between federal law enforcement agencies and financial institutions, as well as among financial institutions, for counter-terrorism purposes. Federal

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banking regulators are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering activities of the applicants. Summit expects to continue to devote significant resources to its Bank Secrecy Act/anti-money laundering program, particularly as risks persistently emerge and evolve and as regulatory expectations escalate.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 ("SOA") addresses, among other issues, corporate governance, auditing and accounting, executive compensation and enhanced and timely disclosure of corporate information. SOA requires our Chief Executive Officer and Chief Financial Officer each 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.

Furthermore, in response to the directives of the SOA, NASDAQ adopted substantially expanded corporate governance criteria for the issuers of securities quoted on the NASDAQ Capital Market (the market on which our common stock is listed for trading). The new NASDAQ rules govern, among other things, the enhancement and regulation of corporate disclosure and internal governance of listed companies and of the authority, role and responsibilities of their boards of directors and, in particular, of "independent" members of such boards of directors, in the areas of nominations, corporate governance, compensation and the monitoring of the audit and internal financial control processes.

Cybersecurity

In 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If we fail to observe the regulatory guidance, we could be subject to various regulatory sanctions, including financial penalties.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. We employ an in-depth, layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber attacks is severe, attacks are sophisticated and increasing in volume and attackers respond rapidly to changes in defensive measures. While to date, we have not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers. See Item 1A. Risk Factors for a

further discussion of risks related to cybersecurity.

Transactions with Affiliates

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.

There are various statutory and regulatory limitations, including those set forth in sections 23A and 23B of the Federal Reserve Act and the related Federal Reserve Regulation W, governing the extent to which the bank will be able to purchase assets from or securities of or otherwise finance or transfer funds to us or our non-banking affiliates. Among other restrictions, such

transactions between the bank and any one affiliate (including Summit) generally will be limited to ten percent (10%) of the bank's capital and surplus and transactions between the bank and all affiliates will be limited to twenty percent (20%) of the bank's capital and surplus. Furthermore, loans and extensions of credit are required to be secured in specified amounts and are required to be on terms and conditions consistent with safe and sound banking practices.

In addition, any transaction by a bank with an affiliate and any sale of assets or provisions of services to an affiliate generally must be on terms that are substantially the same, or at least as favorable, to the bank as those prevailing at the time for comparable transactions with non-affiliated companies.

Incentive Compensation

The Federal Reserve Board reviews, as part of its regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as Summit, that are not "large, complex banking organizations." These reviews are tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of this supervisory initiative will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In June 2010, the Federal Reserve Board, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

In April and May of 2016, the Federal Reserve Board, other federal banking agencies and the SEC (the "Agencies") issued proposed rules to prohibit incentive-based compensation arrangements at covered institutions that could encourage inappropriate risks by providing excessive compensation or that could lead to a material loss. The proposed rules expand significantly beyond the June 2010 principals-based guidance and broadened the scope of covered institutions to include community banks. The proposed rules categorize covered institutions by size and compliance requirements vary according to the size of the covered institutions. The proposed rule (i) prohibits incentive-based compensation arrangements that encourage executive officers, employees, directors or principal shareholders to expose the institution to inappropriate risks by providing excessive compensation (based on the standards for excessive compensation adopted pursuant to the FDIA) and (ii) prohibits incentive-based compensation arrangements for executive officers, employees, directors or principal shareholders that could lead to a material financial loss for the institution.Final rules have not been adopted as of February 2018. If these or other regulations are adopted in a form similar to that initially proposed, they will impose limitations on the manner in which we may structure compensation for our executives.
The scope and content of the U.S. banking regulators' policies on incentive compensation are continuing to develop. It cannot be determined at this time whether or when a final rule will be adopted and whether compliance with such a final rule will adversely affect the ability of Summit and its subsidiaries to hire, retain and motivate their key employees.

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.

Of particular note, banking laws limit the total amount we can lend to any one borrower generally to 15 percent of Summit Community's Tier 1 capital plus its allowance for loan losses. Summit Community evaluated the risks and rewards of lending up to this legal lending limit and established a self-imposed lending limit equal to 85 percent of its legal lending limit. Accordingly, institutions larger than Summit Community have a natural competitive advantage to serve the loan needs of larger clients as their legal lending limits are proportionally greater than ours.

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 addition, 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 February 28, 2018, we employed 349 full-time equivalent employees.

Available Information

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

These reports are also available at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You may read and copy any materials that we file with the SEC at the Public Reference Room on official business days during the hours of 10:00 a.m. to 3:00 p.m. 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

We, like other financial holding companies, are subject to a number of risks that may adversely affect our financial condition or results of operation, many of which are outside of our direct control, though efforts are made to manage those risks while optimizing returns. Among the risks assumed are: (i) credit risk, which is the risk of loss due to loan clients or other counterparties not being able to meet their financial obligations under agreed upon terms, (ii) market risk, which is the risk of loss due to changes in the market value of assets and liabilities due to changes in market interest rates, equity prices and credit spreads, (iii) liquidity risk, which is the risk of loss due to the possibility that funds may not be available to satisfy current or future commitments based on external market issues, investor and customer perception of financial strength and events unrelated to the Company such as war, terrorism, or financial institution market specific issues and (iv) operational risk, which is the risk of loss due to human error, inadequate or failed internal systems and controls, violations of, or noncompliance with, laws, rules, regulations, prescribed practices, or ethical standards and external influences such as market conditions, fraudulent activities, disasters and security risks.

In addition to the other information included or incorporated by reference into this report, readers should carefully consider that the following important factors, among others, could materially impact our business, future results of operations and future cash flows.

RISKS RELATING TO THE ECONOMIC ENVIRONMENT

Our business may be adversely affected by conditions in financial markets and economic conditions generally.

Our business is concentrated in West Virginia and the Northern, Shenandoah Valley and Southwestern regions of Virginia. As a result, our financial condition, results of operations and cash flows are subject to changes if there are changes in the economic conditions in these areas. A prolonged period of economic recession or other adverse economic conditions in these areas could have a negative impact on Summit. A significant decline in general economic conditions nationally, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets, declines in the housing market, a tightening credit environment or other factors could impact these local economic conditions and, in turn, have a material adverse effect on our financial condition and results of operations.

The soundness of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, or other institutional firms. Defaults by financial services institutions and even rumors or questions about a financial institution or the financial services industry in general, have led to market wide liquidity problems and could lead to losses or defaults by us or other institutions. Any such losses could adversely affect our financial condition or results of operations.

The value of certain investment securities is volatile and future declines or other-than-temporary impairments could have a materially adverse effect on future earnings and regulatory capital.

Volatility in the fair value for certain investment securities, whether caused by changes in market conditions, interest rates, credit risk of the issuer, the expected yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities as well as any regulatory rulemaking which could exclude or limit the holdings of certain investment securities. This could have a material adverse impact on our accumulated other comprehensive income and shareholders’ equity depending on the direction of the fluctuations. Furthermore, future

downgrades, defaults or prepayments, including the liquidation of the underlying collateral in certain securities, could result in future classifications as other-than-temporarily impaired. This could have a material impact on our future earnings, although the impact on shareholders' equity will be offset by any amount already included in other comprehensive income for securities that were temporarily impaired.

RISKS RELATING TO OUR BUSINESS

We are subject to extensive government regulation and supervision.

The Company and Summit Community are subject to extensive federal and state regulation and supervision, which vests a significant amount of discretion in the various regulatory authorities. Banking regulations are primarily intended to protect depositors and customers, the Federal Deposit Insurance fund and the banking system as a whole, not security holders. These regulations and supervisory guidance affect our lending practices, capital structure, investment practices, dividend policy and

growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. The Dodd-Frank Act instituted major changes to the banking and financial institutions regulatory regimes. Other changes to statutes, regulations or regulatory policies or supervisory guidance, including changes in interpretation or implementation of statutes, regulations, policies or supervisory guidance, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, policies or supervisory guidance could result in enforcement and other legal actions by Federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, the revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties and/or reputation damage. In this regard, government authorities, including the bank regulatory agencies, are pursuing aggressive enforcement actions with respect to compliance and other legal matters involving financial activities, which heightens the risks associated with actual and perceived compliance failures. Any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

See the section captioned “Supervision and Regulation” included in Item 1. Business on page 1.

We may become subject to additional regulatory restrictions in the event that our regulatory capital levels decline.

Although the Bank is qualified as “well capitalized” under the regulatory framework for prompt corrective action as of December 31, 2017, there is no guarantee that we will not have a decline in our capital category in the future. In the event of such a capital category decline, we would be subject to increased regulatory restrictions that could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects.

If a bank is classified as undercapitalized, the bank is required to submit a capital restoration plan to the FDIC. Pursuant to FDICIA, an undercapitalized bank is prohibited from increasing its assets, engaging in a new line of business, acquiring any interest in any company or insured depository institution, or opening or acquiring a new branch office, except under certain circumstances, including the acceptance by the FDIC of a capital restoration plan for the bank. Furthermore, if a state non-member bank is classified as undercapitalized, the FDIC may take certain actions to correct the capital position of the bank; if a bank is classified as significantly undercapitalized or critically undercapitalized, the FDIC would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring sales of new securities to bolster capital; improvements in management; limits on interest rates paid; prohibitions on transactions with affiliates; termination of certain risky activities and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, FDICIA requires the bank to be placed into conservatorship or receivership within ninety (90) days, unless the Federal Reserve determines that other action would better achieve the purposes of FDICIA regarding prompt corrective action with respect to undercapitalized banks.

Under FDICIA, banks may be restricted in their ability to accept brokered deposits, depending on their capital classification. “Well capitalized” banks are permitted to accept brokered deposits, but all banks that are not well capitalized could be restricted from accepting such deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank. These restrictions could materially and adversely affect our ability to access lower costs funds and thereby decrease our future earnings capacity.

Our financial flexibility could be severely constrained if we are unable to renew our wholesale funding or if adequate financing is not available in the future at acceptable rates of interest. We may not have sufficient liquidity to continue to fund new loan originations and we may need to liquidate loans or other assets unexpectedly in order to repay obligations as they mature. Our inability to obtain regulatory consent to accept or renew brokered deposits could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects

and our ability to continue as a going concern.

Finally, the capital classification of a bank affects the frequency of examinations of the bank, the deposit insurance premiums paid by such bank and the ability of the bank to engage in certain activities, all of which could have a material adverse effect on our business, financial condition, results of operations, cash flows and/or future prospects. Under FDICIA, the FDIC is required to conduct a full-scope, on-site examination of every bank at least once every twelve (12) months.

Our decisions regarding credit risk could be inaccurate and our allowance for loan losses may be inadequate, which could materially and adversely affect our business, financial condition, results of operations, cash flows and/or future prospects.

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

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We attempt to maintain an appropriate allowance for loan losses to provide for estimated probable credit losses inherent in our loan portfolio. As of December 31, 2017, our allowance for loan losses totaled $12.6 million, which represents approximately 0.78% of our total loans. There is no precise method of predicting loan losses and therefore, we always face the risk that charge-offs in future periods will exceed our allowance for loan losses and that we would need to make additional provisions to our allowance for loan losses.

Our methodology for the determination of the adequacy of the allowance for loan losses for impaired loans is based on classifications of loans into various categories and the application of generally accepted accounting principles in the United States. 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 losses is established in different portfolio components, we maintain an allowance that we believe is sufficient to absorb all estimated probable credit losses inherent in our portfolio.

The FDIC and the West Virginia Division of Financial Institutions 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 do business with other financial institutions that could experience financial difficulty.

We do business through the purchase and sale of Federal funds, check clearing and through the purchase and sale of loan participations with other financial institutions. Because these financial institutions have many risks, as do we, we could be adversely affected should one of these financial institutions experience significant financial difficulties or fail to comply with our agreements with them.

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. 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 borrowings, which are generally more sensitive to changes in interest rates and can be adversely affected by general economic conditions.

We have frequently utilized, as a source of funds, certificates of deposit obtained through third parties 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, 2017, brokered deposits totaled $216.9 million, or approximately 13.6% of our total deposits, compared to brokered deposits in the amount of $205.7 million or approximately 15.9% of our total deposits at December 31, 2016. As of December 31, 2017, approximately $46.4 million in brokered deposits, or approximately 21.4% of our total brokered deposits, 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 borrowings with the Federal Home Loan Bank of Pittsburgh, or the FHLB. As of December 31, 2017, our FHLB borrowings maturing within one year totaled $200.0 million. 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.

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

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

- Would have limited amounts of maturing brokered deposits to replace in the short-term, as we have limited our brokered deposits maturing in any one quarter to no more than $50 million.
- Presently has $895 million in available sources of liquid funds which could be drawn upon to fund maturing brokered deposits until Summit Community had restored its capital to well capitalized status.
- Would first seek to restore its capital to well capitalized status through capital contributions from Summit, its parent holding company.
- Would generally have no more than $100 million in brokered deposits maturing in any one year time frame, which is well within its presently available sources of liquid funds, if in the event Summit does not have the capital resources to restore Summit Community's capital to well capitalized status. One year would give Summit Community ample time to raise alternative funds either through retail deposits or the sale of assets and obtain capital resources to restore it to well capitalized status.

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

- Would severely curtail lending and other growth activities until such time as access to this line could be restored, thus eliminating the need for net new advances.
- Would still have available current liquid funding sources secured by unemcumbered loans and securities totaling $458 million aside from its FHLB line, which would result in a funding source of approximately $359 million.

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

- Presently has $895 million in available sources of liquid funds which could be drawn upon immediately to fund any "net run off" of deposits from this activity.
- Would severely curtail lending and other growth activities so as to preserve the availability of as much contingency funds as possible.
- Would begin offering its own competitive deposit program when deemed prudent so as to restore the retail deposits lost to the competition.

We pursue a strategy of supplementing internal growth by acquiring other financial companies or their assets and liabilities that we believe will help us fulfill our strategic objectives and enhance our earnings. There are risks associated with this strategy.

As part of our general growth strategy, we have partially expanded our business through acquisitions. We completed the FIrst Century Bankshares, Inc. ("FCB") acquisition in April 2018 and the acquisition of Highland County Bankshares, Inc. ("HCB") in October 2016. Although our business strategy emphasizes organic expansion, we continue, from time to time in the ordinary course of business, to engage in preliminary discussions with potential acquisition targets. There can be no assurance that, in the future, we will successfully identify suitable acquisition candidates, complete acquisitions and successfully integrate acquired operations into our existing operations or expand into new markets. The consummation of any future acquisitions may dilute shareholder value or may have an adverse effect upon our operating results while the operations of the acquired business are being integrated into our operations. In addition, once integrated, acquired operations may not achieve levels of profitability comparable to those achieved by our existing operations, or otherwise perform as expected. Further, transaction-related expenses may adversely affect our earnings. These adverse effects on our earnings and results of operations may have a negative impact on the value of our common stock. Acquiring banks, bank branches or other businesses involves risks commonly associated with acquisitions, including:

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We may be exposed to potential asset quality issues or unknown or contingent liabilities of the banks, businesses, assets, and liabilities we acquire. If these issues or liabilities exceed our estimates, our results of operations and financial condition may be materially negatively affected;

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- Prices at which acquisitions can be made fluctuate with market conditions. We have experienced times during which acquisitions could not be made in specific markets at prices we considered acceptable and expect that we will experience this condition in the future;
- The acquisition of other entities generally requires integration of systems, procedures and personnel of the acquired entity into our company to make the transaction economically successful. This integration process is complicated and time consuming and can also be disruptive to the customers of the acquired business. If the integration process is not conducted successfully and with minimal effect on the acquired business and its customers, we may not realize the anticipated economic benefits of particular acquisitions within the expected time frame, and we may lose customers or employees of the acquired business. We may also experience greater than anticipated customer losses even if the integration process is successful.
- To the extent our costs of an acquisition exceed the fair value of the net assets acquired, the acquisition will generate goodwill. As discussed below, we are required to assess our goodwill for impairment at least annually, and any goodwill impairment charge could have a material adverse effect on our results of operations and financial condition; and
- To finance an acquisition, we may borrow funds, thereby increasing our leverage and diminishing our liquidity, or raise additional capital, which could dilute the interests of our existing stockholders.

The value of our goodwill and other intangible assets may decline.

Goodwill and other intangible assets are subject to a decline, perhaps even significantly, for several reasons including if there is a significant decline in our expected future cash flows, change in the business environment, or a material and sustained decline in the market value of our stock, which may require us to take future charges related to the impairment of that goodwill and other intangible assets in the future, which could have a material adverse effect on our financial condition and results of our operations.

We operate 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.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on those properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

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 FRB. 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.

The repeal of Federal prohibitions on payment of interest on demand deposits could increase our interest expense as interest rates rise.

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. We do not yet know what interest rates other institutions may offer as market interest rates begin to increase. Our interest expense will increase and our net interest margin will decrease if we begin offering interest on demand deposits to attract additional customers or maintain current customers, which could have a material adverse effect on our business, financial condition and results of operations.

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.

Our business may be adversely affected by increasing prevalence of fraud and other financial crimes.

As a financial institution, we are subject to risk of loss due to fraud and other financial crimes. Nationally, reported incidents of fraud and other financial crimes have increased. We believe we have controls in place to detect and prevent such losses but in some cases multi-party collusion or other sophisticated methods of hiding fraud, may not be readily detected or detectable, and could result in losses that affect our financial condition and results of our operations.

Financial crime is not limited to the financial services industry. Our customers could experience fraud in their businesses, which could materially impact their ability to repay their loans, and deposit customers in all financial institutions are constantly and unwittingly solicited by others in fraud schemes that vary from easily detectable and obvious attempts to high-level and very complex international schemes that could drain an account of a significant amount and require detailed financial forensics to unravel. While we have controls in place, contractual agreements with our customers partitioning liability, and insurance to help mitigate the risk, none of these are guarantees that we will not experience a loss, potentially a loss that could have a material adverse effect on our financial condition, reputation and results of our operations.

Our information systems may experience failure, interruption or breach in security.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. Any failure, interruption or breach in security of these systems could result in significant disruption to our operations. Information security breaches and cybersecurity-related incidents may include, but are not limited to, attempts to access information, including customer and company information, malicious code, computer viruses and denial of service attacks that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer information), account takeovers, unavailability of service or other events. These types of threats may derive from human error, fraud or malice on the part of external or internal parties, or may result from accidental technological failure. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. Our technologies, systems, networks

and software and those of other financial institutions have been and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at us. The risk of a security breach or disruption, particularly through cyber attack or cyber intrusion, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased.

Our business requires the collection and retention of large volumes of customer data, including personally identifiable information in various information systems that we maintain and in those maintained by third parties with whom we contract to provide data services. We also maintain important internal company data such as personally identifiable information about our employees and information relating to our operations. The integrity and protection of that customer and company data is important to us. Our collection of such customer and company data is subject to extensive regulation and oversight.

Our customers and employees have been and will continue to be, targeted by parties using fraudulent e-mails and other communications in attempts to misappropriate passwords, bank account information or other personal information or to introduce viruses or other malware through "Trojan horse" programs to our information systems and/or our customers' computers. Though we endeavor to mitigate these threats through product improvements, use of encryption and authentication technology and customer and employee education, such cyber attacks against us or our merchants and our third party service providers remain a serious issue. The pervasiveness of cybersecurity incidents in general and the risks of cyber crime are complex and continue to evolve. More generally, publicized information concerning security and cyber-related problems could inhibit the use or growth of electronic or web-based applications or solutions as a means of conducting commercial transactions.

Although we make significant efforts to maintain the security and integrity of our information systems and have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well protected information, networks, systems and facilities remain potentially vulnerable because attempted security breaches, particularly cyber attacks and intrusions, or disruptions will occur in the future and because the techniques used in such attempts are constantly evolving and generally are not recognized until launched against a target and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures and thus it is virtually impossible for us to entirely mitigate this risk. While we maintain specific “cyber” insurance coverage, which would apply in the event of various breach scenarios, the amount of coverage may not be adequate in any particular case. Furthermore, because cyber threat scenarios are inherently difficult to predict and can take many forms, some breaches may not be covered under our cyber insurance coverage.

A security breach or other significant disruption of our information systems or those related to our customers, merchants and our third party vendors, including as a result of cyber attacks, could (i) disrupt the proper functioning of our networks and systems and therefore our operations and/or those of certain of our customers; (ii) result in the unauthorized access to and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers; (iii) result in a violation of applicable privacy, data breach and other laws, subjecting us to additional regulatory scrutiny and expose the us to civil litigation, governmental fines and possible financial liability; (iv) require significant management attention and resources to remedy the damages that result; or (v) harm our reputation or cause a decrease in the number of customers that choose to do business with us. The occurrence of any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

The negative economic effects caused by terrorist attacks, including cyber attacks, potential attacks and other destabilizing events, would likely contribute to the deterioration of the quality of our loan portfolio and could reduce our customer base, level of deposits and demand for our financial products, such as loans.

High inflation, natural disasters, acts of terrorism, including cyber attacks, an escalation of hostilities or other international or domestic occurrences and other factors could have a negative impact on the economy of the Mid-Atlantic regions in which we operate. An additional economic downturn in our markets would likely contribute to the deterioration of the quality of our loan portfolio by impacting the ability of our customers to repay loans, the value of the collateral securing loans and may reduce the level of deposits in our bank and the stability of our deposit funding sources. An additional economic downturn could also have a significant impact on the demand for our products and services. The cumulative effect of these matters on our results of operations and financial condition could be adverse and material.

We are dependent upon third parties for certain information system, data management and processing services and to provide key components of our business infrastructure.

We outsource certain information system and data management and processing functions to third party providers. These third party service providers are sources of operational and informational security risk to us, including risks associated with operational errors, information system interruptions or breaches and unauthorized disclosures of sensitive or confidential client or customer information. If third party service providers encounter any of these issues,

or if we have difficulty communicating with them, we could be exposed to disruption of operations, loss of service or connectivity to customers, reputational damage and litigation risk that could have a material adverse effect on our results of operations or our business.

Third party vendors provide key components of our business infrastructure such as internet connections, network access and core application processing. While we have selected these third party vendors carefully, we do not control their actions.

These services must be available on a continuous and timely basis and be in compliance with any regulatory requirements. Failure to do so could substantially harm our business.

We often purchase services from vendors under agreements that typically can be terminated on a periodic basis. There can be no assurance, however, that vendors will be able to meet their obligations under these agreements or that we will be able to compel them to do so. Risks of relying on vendors include the following:

- If an existing agreement expires or a certain service is discontinued by a vendor, then we may not be able to continue to offer our customers the same breadth of products and our operating results would likely suffer unless we are able to find an alternate supply of a similar service.
- Agreements we may negotiate in the future may commit us to certain minimum spending obligations. It is possible that we will not be able to create the market demand to meet such obligations.
- If market demand for our products increases suddenly, our current vendors might not be able to fulfill our commercial needs, which would require us to seek new arrangements or new sources of supply and may result in substantial delays in meeting market demand.
- We may not be able to control or adequately monitor the quality of services we receive from our vendors. Poor quality services could damage our reputation with our customers.

Potential problems with vendors such as those discussed above could have a significant adverse effect on our business, lead to higher costs and damage our reputation with our customers and, in turn, have a material adverse effect on our financial condition and results of operations.

Changes in accounting standards could impact reported earnings.

The accounting standard setting bodies, including the Financial Accounting Standards Board and other regulatory bodies, periodically change the financial accounting and reporting standards affecting the preparation of financial statements. These changes are not within our control and could materially impact our financial statements.

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.

Our potential inability to integrate companies we may acquire in the future could have a negative effect on our expenses and results of operations.

On occasion, we may engage in a strategic acquisition when we believe there is an opportunity to strengthen and expand our business. To fully benefit from such acquisition, however, we must integrate the administrative, financial, sales, lending, collections and marketing functions of the acquired company. If we are unable to successfully integrate an acquired company, we may not realize the benefits of the acquisition and our financial results may be negatively affected. A completed acquisition may adversely affect our financial condition and results of operations, including our capital requirements and the accounting treatment of the acquisition. Completed acquisitions may also lead to significant unexpected liabilities after the consummation of these acquisitions.

RISKS RELATING TO AN INVESTMENT IN OUR SECURITIES

Our ability to pay dividends is limited.

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. 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 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 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 could have a material adverse effect on our business, financial condition and results of operations.

Our stock price can be volatile.

Stock price volatility may make it more difficult for our shareholders to resell their common stock when they want and at prices they find attractive. Our stock price can fluctuate significantly in response to a variety of factors, including, among other things:

- Actual or anticipated negative variations in quarterly results of operations;
- Negative recommendations by securities analysts;
- Poor operating and stock price performance of other companies that investors deem comparable to us;
- News reports relating to negative trends, concerns and other issues in the financial services industry or the economy in general;
- Negative perceptions in the marketplace regarding us and/or our competitors;
- New technology used, or services offered, by competitors;
- Adverse changes in interest rates or a lending environment with prolonged low interest rates;
- Adverse changes in the real estate market;
- Negative economic news;
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- Regulatory changes affecting our industry generally or our businesses and operations;
- Announcements of strategic developments, acquisitions and other material events by us or our competitors;
- 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;
- Rumors or erroneous information;
- New litigation or changes in existing litigation;
- Adverse regulatory actions;
- Adverse changes in government regulations; and
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease, regardless of operating results.

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

As of February 21, 2018 our executive officers and directors beneficially own 12.93% (computed in accordance with Exchange Act Rule 13d-3) 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 shareholders 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.

There may be future sales of additional common stock or preferred stock or other dilution of our equity, which may adversely affect the market price of our common stock.

Our board of directors is authorized to cause us to issue additional classes or series of preferred shares without any action on the part of the shareholders. The board of directors also has the power, without shareholder approval, to set the terms of any such classes or series of preferred shares that may be issued, including voting rights, dividend rights and preferences over the common stock with respect to dividends or upon the liquidation, dissolution or winding-up of our business and other terms. If we issue

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preferred shares in the future that have a preference over the common stock with respect to the payment of dividends or upon liquidation, dissolution or winding-up, or if we issue preferred shares with voting rights that dilute the voting power of the common stock, the rights of holders of the common stock or the market price of the common stock could be adversely affected.

The market price of our common stock could decline as a result of sales of a large number of shares of common stock or preferred stock or similar securities in the market or the perception that such sales could occur.

Holders of our junior subordinated debentures have rights that are senior to those of our shareholders.

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 approximately $19.6 million at December 31, 2017 and 2016.

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 (5) years, during which time no dividends may be paid on our common stock. In 2017, our total interest payments on these junior subordinated debentures approximated $693,000. Based on current rates, our quarterly interest payment obligation on our junior subordinated debentures is approximately $189,000.

The capital securities held by our three trust subsidiaries qualify as Tier 1 capital under FRB guidelines. In accordance with these guidelines, trust preferred securities generally are limited to twenty-five percent (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.

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 shareholders, 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 (1/3) of our Board of Directors can be replaced by shareholders at any annual meeting.

Your shares are not an insured deposit.

Your investment in our common stock is not 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 RISKS

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

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our principal executive office is located at 300 North Main Street, Moorefield, West Virginia, in a building owned by Summit Community. Summit Community's headquarters and branch locations occupy offices which are either owned or operated under lease arrangements. At December 31, 2017, Summit Community operated 30 banking offices. Summit Insurance Services, LLC operates out of the Moorefield, West Virginia and Leesburg, Virginia, offices of Summit Community.

	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	1	1	2
Warrenton, Virginia	—	1	1
Martinsburg, West Virginia	1	—	1
Monterey, Virginia	1	—	1
Hot Springs, Virginia	1	—	1
Churchville, Virginia	—	1	1
Bluefield, West Virginia	2	—	2
Princeton, West Virginia	2	—	2
Oceana, West Virginia	1	—	1
Pineville, West Virginia	1	—	1
Bluefield, Virginia	1	—	1
Wytheville, Virginia	1	—	1
Max Meadows, Virginia	1	—	1
Hinton, West Virginia	1	—	1
Beckley, West Virginia	1	—	1
Christiansburg, Virginia	—	1	1

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 beginning on page 85.

Item 3. Legal Proceedings

Information required by this item is set forth under the caption "Legal Contingencies" in Note 17 of our consolidated financial statements beginning on page 94.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II.

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

Common Stock Dividend and Market Price Information: Our stock trades on the NASDAQ Capital 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
2017				
Dividends paid	$ 0.11	$ 0.11	$ 0.11	$ 0.11
High Bid	27.60	23.40	26.62	28.16
Low Bid	19.13	20.01	20.93	23.62
2016				
Dividends paid	$ 0.10	$ 0.10	$ 0.10	$ 0.10
High Bid	16.14	20.77	20.47	30.06
Low Bid	11.13	14.91	16.45	18.05

The payment of dividends is subject to the restrictions set forth in the West Virginia Business Corporation Act and the limitations imposed by the FRB. Payment of dividends by Summit is primarily dependent upon receipt of dividends from Summit Community. Payment of dividends by Summit Community is regulated by the Federal Reserve System and generally, the prior approval of the FRB is required if the total dividends declared by a state member bank in any calendar year exceeds its net profits, as defined, for that year combined with its retained net profits for the preceding two years. Additionally, prior approval of the FRB is required when a state member bank has deficit retained earnings but has sufficient current year's net income, as defined, plus the retained net profits of the two preceding years. The FRB may prohibit dividends if it deems the payment to be an unsafe or unsound banking practice. The FRB has issued guidelines for dividend payments by state member banks emphasizing that proper dividend size depends on the bank's earnings and capital. See Note 19 of our consolidated financial statements on page 96.

As of February 21, 2018, there were approximately 1,171 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.

The following table sets forth certain information regarding Summit's purchase of its common stock under Summit's ESOP for the quarter ended December 31, 2017.

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

October 1, 2017 - October 31, 2017	—	$	——	—
November 1, 2017 - November 30, 2017	—	—	—	—
December 1, 2017 - December 31, 2017	—	—	—	—

(a) Shares purchased under the Employee Stock Ownership Plan.

Performance Graph: Set forth below is a line graph comparing the cumulative total return of Summit's common stock assuming reinvestment of dividends, with that of the NASDAQ Composite Index ("NASDAQ Composite"), and the SNL Small Cap U.S. Bank Index for the five year period ending December 31, 2017.

The cumulative total shareholder return assumes a $100 investment on December 31, 2012 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.

	For the Year Ended					
Index	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
Summit Financial Group, Inc.	100.00	204.75	245.87	252.32	597.45	582.19
NASDAQ Composite	100.00	140.12	160.78	171.97	187.22	242.71
SNL Small Cap U.S. Bank	100.00	139.47	147.01	161.00	228.27	239.41

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 each of the five (5) years ended December 31, 2017. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes contained elsewhere in this report.

		For the Year Ended (unless otherwise noted)			
Dollars in thousands, except per share amounts	2017	2016	2015	2014	2013
Summary of Operations					
Interest income	$84,527	$64,091	$58,883	$57,626	$57,280
Interest expense	18,380	15,084	12,867	15,241	18,477
Net interest income	66,147	49,007	46,016	42,385	38,803
Provision for loan losses	1,250	500	1,250	2,250	4,500
Net interest income after provision for loan losses	64,897	48,507	44,766	40,135	34,303
Noninterest income	14,427	11,600	11,861	11,223	11,209
Noninterest expense	57,745	34,802	33,632	35,324	34,756
Income before income taxes	21,579	25,305	22,995	16,034	10,756
Income tax expense	9,664	8,008	6,893	4,678	2,688
Net income	11,915	17,297	16,102	11,356	8,068
Dividends on preferred shares	—	—	—	771	775
Net income applicable to common shares	$11,915	$17,297	$16,102	$10,585	$7,293
Balance Sheet Data (at year end)					
Assets	$2,134,240	$1,758,647	$1,492,429	$1,443,568	$1,386,227
Securities available for sale	328,723	266,542	280,792	282,834	288,780
Loans, net	1,593,744	1,307,862	1,079,331	1,019,842	937,070
Deposits	1,600,601	1,295,519	1,066,709	1,061,314	1,003,812
Short-term borrowings	250,499	224,461	171,394	123,633	62,769
Long-term borrowings	45,751	46,670	75,581	77,490	163,516
Shareholders' equity	201,505	155,360	143,744	131,644	111,072
Credit Quality					
Net loan charge-offs	$359	$298	$945	$3,742	$9,774
Nonperforming assets	36,861	39,090	41,340	50,244	72,346
Allowance for loan losses	12,565	11,674	11,472	11,167	12,659
Per Share Data					
Earnings per share					
Basic earnings	$1.00	$1.62	$1.56	$1.40	$0.98
Diluted earnings	1.00	1.61	1.50	1.17	0.84
Book value per common share (at year end) (A)	16.30	14.47	13.48	12.60	11.55
Tangible book value per common share (at year end) (A)	14.08	13.20	12.78	11.86	10.72
Cash dividends	$0.44	0.40	0.32	—	—
Performance Ratios					
Return on average equity	6.40 %	11.53 %	11.62 %	9.54 %	7.38 %
Return on average tangible equity	7.35 %	12.27 %	12.29 %	10.22 %	7.98 %
Return on average assets	0.59 %	1.08 %	1.10 %	0.80 %	0.58 %

Equity to assets	9.4	%	8.8	%	9.6	%	9.1	%	8.0	%
Tangible equity to tangible assets	8.3	%	8.1	%	9.2	%	8.6	%	7.5	%
Tangible common equity to tangible assets	8.3	%	8.1	%	9.2	%	8.0	%	6.8	%
Dividend payout ratio	44.0	%	24.7	%	21.1	%	—	%	—	%

(A)- Assumes conversion of outstanding convertible preferred stock in 2013 and 2014.

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

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 $2.13 billion community-based financial services company providing a full range of banking and other financial services to individuals and businesses through our three operating segments: community banking, trust and wealth management and insurance. Our community bank, Summit Community Bank, Inc. has a total of 30 banking offices located in West Virginia and Virginia. Our trust and wealth management division offers trust services and other non-bank financial products principally within our community bank's market area. In addition, we also operate Summit Insurance Services, LLC in Moorefield, West Virginia and Leesburg, Virginia, which provides insurance brokerage services to individuals and businesses covering corporate and personal property and casualty insurance products, as well as group health and life insurance products and consulting services. See Note 20 of the accompanying consolidated financial statements for our segment information. Summit Financial Group, Inc. employs approximately 349 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 2017

- 2017 net income was $11.92 million ($1.00 per diluted share) compared to $17.30 million ($1.61 per diluted share) in 2016. 2017 earnings were negatively impacted by a $9.9 million (or $6.2 million after-tax or $0.52 per diluted share) litigation settlement charge and a $3.5 million ($0.29 per diluted share) preliminary tax charge due to enactment of the Tax Cuts and Jobs Act ("TCJA")
- We completed our acquisition of Bluefield, West Virginia-based First Century Bankshares, Inc. ("FCB") and its subsidiary, First Century Bank, on April 1, 2017. At consummation, FCB had total assets of $406.2 million, loans of $229.0 million and deposits of $350.0 million. In addition, our merger related expenses totaled $1.59 million in 2017. The results of operations of FCB are included in the consolidated results of operations from the date of acquisition.
-

Net interest margin increased 28 basis points in 2017, principally due to a 25 basis point increase in our yield on interest earning assets, as our taxable loan and taxable securities yields grew 23 and 36 basis points.

- Net revenues increased $20.5 million, or 34.1 percent during 2017 primarily as result of our two recent acquisitions.
- We achieved loan growth, excluding mortgage warehouse lines of credits and FCB's purchased loans, of 9.6 percent, or $113.0 million during 2017.
- Nonperforming assets declined to their lowest level since 2008, representing 1.73 percent of total assets at year end 2017 compared to 2.22 percent at the prior year end.
- During 2017, provisions for loan losses increased by $750,000 primarily due to loan growth.
- Cash dividends paid on our common stock in 2017 totaled $0.44 per share compared to $0.40 paid per share in 2016.

OUTLOOK

The year just concluded marked another significant milestone towards Summit's goal of being a consistent, high-performing community banking institution. Our recent FCB and Highland County Bankshares, Inc. ("HCB") purchases have positively impacted our bottom line and represent significant opportunities for us. The combination of Summit and these two financially strong institutions which have similar cultures and core values proves our ability to successfully execute on a disciplined M&A growth strategy and gives us optimism as we look forward to 2018 and beyond. While we could be challenged by a variety of potential economic uncertainties, management anticipates continuing positive trends represented by our growing loan portfolio, increasing revenues, improved net interest margin, low overhead costs, continued reductions in problem assets and improved earnings.

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

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

Allowance for Loan Losses: The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 8 to the 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 an analysis by reporting unit at least annually by comparing the fair value of a reporting unit with its carrying amount to determine whether write-downs of the recorded balances are necessary. An entity still has the option to perform a qualitative assessment for a reporting unit to determine if a quantitative impairment test is necessary. If the fair value is less than the carrying value, an expense may be required on our books to write down the goodwill to the proper carrying value.

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

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, including, but not limited to, property held for sale, impaired loans and derivatives. 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 a three-level hierarchy (e.g., Level 1, Level 2 and Level 3) . Fair value determination 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.

Accounting for Acquired Loans: Loans acquired are initially recorded at their acquisition date fair values. The fair value of the acquired loans are based on the present value of the expected cash flows, including principal, interest and prepayments. Periodic principal and interest cash flows are adjusted for expected losses and prepayments, then discounted to determine the present value and summed to arrive at the estimated fair value. Fair value estimates involve assumptions and judgments as to credit risk, interest rate risk, prepayment risk, liquidity risk, default rates, loss severity, payment speeds, collateral values and discount rate.

Acquired loans are divided into loans with evidence of credit quality deterioration (acquired impaired) and loans that do not meet this criteria (acquired performing). Acquired impaired loans have experienced a deterioration of credit quality from origination to acquisition for which it is probable that we will be unable to collect all contractually required payments receivable, including both principal and interest. In the assessment of credit quality, numerous assumptions, interpretations and judgments must be made, based on internal and third-party credit quality information and ultimately the determination as to the probability that all contractual cash flows will not be able to be collected. This is a point in time assessment and inherently subjective due to the nature of the available information and judgment involved.

Subsequent to the acquisition date, we continue to estimate the amount and timing of cash flows expected to be collected on acquired impaired loans. Increases in expected cash flows will generally result in a recovery of any previously recorded allowance for loan losses, to the extent applicable, and/or a reclassification from the nonaccretable difference to accretable yield, which will be recognized prospectively. The present value of any decreases in expected cash flows after the acquisition date will generally result in an impairment charge recorded as a provision for loan losses, resulting in an increase to the allowance for loan losses.

For acquired performing loans, the difference between the acquisition date fair value and the contractual amounts due at the acquisition date represents the fair value adjustment. Fair value adjustments may be discounts (or premiums) to a loan’s cost basis and are accreted (or amortized) to interest income over the loan’s remaining life using the level yield method. Subsequent to the acquisition date, the methods utilized to estimate the required allowance for loan losses for these loans is similar to originated loans.

See Note 3 and Note 7 of the accompanying consolidated financial statements for additional information regarding our acquired loans.

Deferred Income Tax Assets: At December 31, 2017, we had net deferred tax assets of $6.4 million. Based on our ability to offset the net deferred tax asset against expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at December 31, 2017. All available evidence, both positive and negative, was considered to determine whether, based on the weight of that evidence, impairment should be recognized. However, our forecast process includes judgmental and quantitative elements that may be subject to significant change. If our forecast of taxable income within the carryforward periods available under applicable law is not sufficient to cover the amount of net deferred tax assets, such assets may become impaired. We recorded a $3.5 million preliminary charge to income tax expense to remeasure our net deferred tax assets at the lower corporate federal income tax rate due to enactment of the TCJA.

BUSINESS SEGMENT RESULTS

We are organized and managed along three major business segments, as described in Note 20 of the accompanying consolidated financial statements. The results of each business segment are intended to reflect each segment as if it were a stand alone business. Net income by segment follows:

Dollars in thousands	2017	2016	2015
Community banking	$12,365	$18,314	$17,265
Trust and wealth management	95	21	84
Insurance services	514	169	46
Parent	(1,059)	(1,207)	(1,293)
Consolidated net income	$11,915	$17,297	$16,102

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RESULTS OF OPERATIONS

Earnings Summary

Net income decreased 31.1% during 2017 to $11.9 million, compared to $17.3 million in 2016, which was 7.4% greater than 2015's $16.1 million. On a per share basis, net income was $1.00, $1.61 and $1.50 per diluted share for 2017, 2016 and 2015, respectively, representing a 37.9% decrease in 2017 and a 7.3% increase in 2016. Return on average equity was 6.40% in 2017 compared to 11.53% in 2016 and 11.62% in 2015. Return on average assets for the year ended December 31, 2017 was 0.59% compared to 1.08% in 2016 and 1.10% in 2015. Included in 2017's net income were a $9.9 million pre-tax ($6.2 million after-tax or $0.52 per diluted share) litigation settlement charge, $3.5 million ($0.29 per diluted share) preliminary income tax charge due to enactment of the TCJA, and $1.6 million ($0.08 per diluted share) of merger related expenses. 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.

Net interest income on a fully tax equivalent basis, average balance sheet amounts and corresponding average yields on interest earning assets and costs of interest bearing liabilities for the years 2013 through 2017 are presented in Table I. Table II presents, for the periods indicated, the changes in 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.

Due to increases in interest earning assets and interest bearing liabilities from the FCB and HCB acquisitions, organic loan growth and recent FOMC increases to its target Federal funds rate, we have experienced higher levels of net interest income and an increased net interest margin.

Net interest income on a fully tax equivalent basis totaled $68.6 million, $50.6 million and $47.6 million for the years ended December 31, 2017, 2016 and 2015, respectively, representing an increase of 35.5% in 2017 and 6.4% in 2016. During 2017, 2016 and 2015, the volumes of both interest earning assets and interest bearing liabilities increased.

During 2017, our earnings on interest earning assets increased $21.3 million due to both higher volumes and higher yields, while the cost of interest bearing liabilities increased $3.3 million due to higher volumes of interest bearing deposits.

During 2016, our earnings on interest earning assets increased $5.3 million as the increase in earnings due to higher volumes, primarily loans, more than offset reductions in yield, while the cost of interest bearing liabilities increased $2.2 million primarily due to both higher cost of funds, principally on short-term borrowings, and higher volumes of interest bearing deposits.

During 2015, our earnings on interest earning assets increased $1.3 million as the increase in earnings due to higher volumes more than offset the reduction in yield, while the cost of interest bearing liabilities declined $2.4 million primarily due to lower volumes of long term borrowings and subordinated debentures.

Total average earning assets increased 25.1% to $1.87 billion at December 31, 2017 from $1.49 billion at December 31, 2016.   Total average interest bearing liabilities increased 23.1% to $1.60 billion at December 31, 2017, compared to $1.30 billion at December 31, 2016.

Our net interest margin was 3.67% for 2017 compared to 3.39% and 3.50% for 2016 and 2015, respectively. Our net interest margin increased 28 basis points in 2017 primarily due to the 25 basis point increase in yield on interest earning assets. Our net interest margin decreased 11 basis points in 2016 principally as result of the yield on interest earning assets declining 5 basis points while the cost of interest bearing liabilities increased 8 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 net interest income.

Assuming no significant unanticipated changes in market interest rates, we expect growth in our net interest income to continue over the near term primarily due to continuing expected growth in loans. We continue to monitor the net interest margin through net interest income simulation to minimize the potential for any significant negative impact. As a result of enactment of the TCJA in late 2017, our statutory corporate Federal income tax rate effective January 1, 2018, declined from 35% to 21%. Accordingly, the taxable equivalent adjustment to interest earned on tax-exempt securities and loans likewise will decline proportionally beginning in 2018. We anticipate the impact of the enactment of the TCJA will reduce our net interest margin 6-8 basis points beginning in 2018.

See the “Market Risk Management” section for further discussion of the impact changes in market interest rates could have on us. Further analysis of our yields on interest earning assets and interest bearing liabilities are presented in Tables I and II below.

Table I - Average Balances - Assets, Liabilities and Shareholders' Equity,
Interest Earnings & Expenses and Average Yields/Rates

	Average Balances				
Dollars in thousands	2017	2016	2015	2014	2013
ASSETS					
Interest earning assets					
Loans, net of unearned interest (1)					
Taxable	$1,480,601	$1,177,445	$1,049,172	$984,723	$949,616
Tax-exempt (2)	14,899	14,628	13,706	7,823	5,440
Securities					
Taxable	200,596	202,795	209,316	211,700	208,588
Tax-exempt (2)	129,342	79,571	77,280	81,549	75,707
Interest bearing deposits with other banks	43,400	19,211	8,878	9,325	7,821
	1,868,838	1,493,650	1,358,352	1,295,120	1,247,172
Noninterest earning assets					
Cash and due from banks	8,492	3,968	3,839	3,756	4,381
Premises and equipment	31,750	21,858	20,707	20,346	20,926
Other assets	109,456	90,957	94,996	112,504	125,629
Allowance for loan losses	(12,196)	(10,836)	(11,307)	(11,724)	(15,152)
Total assets	$2,006,340	$1,599,597	$1,466,587	$1,420,002	$1,382,956
LIABILITIES AND SHAREHOLDERS' EQUITY					
Liabilities					
Interest bearing liabilities					
Interest bearing demand deposits	$358,225	$220,708	$208,160	$192,190	$181,413
Savings deposits	363,949	306,312	255,186	238,340	195,398
Time deposits	609,156	491,652	481,732	513,110	556,644
Short-term borrowings	205,743	190,876	151,102	100,786	34,098
Long-term borrowings and subordinated debentures	65,629	92,343	99,805	142,213	202,237
	1,602,702	1,301,891	1,195,985	1,186,639	1,169,790
Noninterest bearing liabilities					
Demand deposits	200,707	128,894	116,995	104,262	94,943
Other liabilities	16,669	18,795	15,024	10,119	8,951
Total liabilities	1,820,078	1,449,580	1,328,004	1,301,020	1,273,684
Shareholders' equity - preferred	—	—	1,786	9,276	9,313
Shareholders' equity - common	186,262	150,017	136,797	109,706	99,959
Total shareholders' equity	186,262	150,017	138,583	118,982	109,272
Total liabilities and shareholders' equity	$2,006,340	$1,599,597	$1,466,587	$1,420,002	$1,382,956
Net Interest Earnings					
Net Interest Margin					

(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 $998,000, $528,000 and $473,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

(2) For purposes of this table, interest income on tax-exempt securities and loans has been adjusted assuming a Federal tax rate of 35% for 2017 and 34% for all other years presented. The taxable equivalent adjustment results in an increase in interest income of $2,413,000, $1,589,000 and $1,542,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

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	Interest Earnings/Expense					Average Yield/Rate				
Dollars in thousands	2017	2016	2015	2014	2013	2017	2016	2015	2014	2013
ASSETS										
Interest earning assets										
Loans, net of unearned interest (1)										
Taxable	$74,365	$56,439	$51,554	$50,078	$50,505	5.02%	4.79%	4.91%	5.09%	5.32%
Tax-exempt (2)	835	820	779	533	388	5.60%	5.61%	5.68%	6.81%	7.13%
Securities										
Taxable	5,071	4,395	4,328	4,692	4,131	2.53%	2.17%	2.07%	2.22%	1.98%
Tax-exempt (2)	6,060	3,853	3,756	3,780	3,647	4.69%	4.84%	4.86%	4.64%	4.82%
Interest bearing deposits with other banks	609	173	8	8	5	1.40%	0.90%	0.09%	0.09%	0.06%
	86,940	65,680	60,425	59,091	58,676	4.65%	4.40%	4.45%	4.56%	4.70%
LIABILITIES AND SHAREHOLDERS' EQUITY										
Liabilities										
Interest bearing liabilities										
Interest bearing demand deposits	1,169	376	251	222	255	0.33%	0.17%	0.12%	0.12%	0.14%
Savings deposits	2,563	2,296	1,781	1,580	1,152	0.70%	0.75%	0.70%	0.66%	0.59%
Time deposits	7,478	6,292	6,304	7,193	8,985	1.23%	1.28%	1.31%	1.40%	1.61%
Short-term borrowings	4,473	2,288	525	306	95	2.17%	1.20%	0.35%	0.30%	0.28%
Long-term borrowings subordinated debentures	2,697	3,832	4,007	5,940	7,991	4.11%	4.15%	4.01%	4.18%	3.95%
	18,380	15,084	12,868	15,241	18,478	1.15%	1.16%	1.08%	1.28%	1.58%
	$68,560	$50,596	$47,557	$43,850	$40,198					
						3.67%	3.39%	3.50%	3.39%	3.22%

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

	2017 Versus 2016 Increase (Decrease) Due to Change in:			2016 Versus 2015 Increase (Decrease) Due to Change in:		
Dollars in thousands	Volume	Rate	Net	Volume	Rate	Net
Interest earned on						
Loans						
Taxable	$15,117	$2,809	$17,926	$6,180	$(1,295)	$4,885
Tax-exempt	15	—	15	52	(11)	41
Securities						
Taxable	(48)	724	676	(138)	205	67
Tax-exempt	2,336	(129)	2,207	111	(14)	97
Interest bearing deposits with other banks	302	134	436	19	146	165
Total interest earned on interest earning assets	17,722	3,538	21,260	6,224	(969)	5,255
Interest paid on						
Interest bearing demand deposits	321	472	793	16	109	125
Savings deposits	412	(145)	267	376	139	515
Time deposits	1,452	(266)	1,186	129	(141)	(12)
Short-term borrowings	191	1,994	2,185	171	1,592	1,763
Long-term borrowings and subordinated debentures	(1,099)	(36)	(1,135)	(307)	132	(175)
Total interest paid on interest bearing liabilities	1,277	2,019	3,296	385	1,831	2,216
Net interest income	$16,445	$1,519	$17,964	$5,839	$(2,800)	$3,039

Noninterest Income

Noninterest income totaled 0.72%, 0.73% and 0.81%, of average assets in 2017, 2016 and 2015, respectively. Noninterest income totaled $14.4 million in 2017 compared to $11.6 million in 2016 and $11.9 million in 2015. The 2017 increase is principally due to higher trust and wealth management fees and service fees related to deposit accounts as a result of the FCB and HCB acquisitions. Further detail regarding noninterest income is reflected in the following table.

Table III - Noninterest Income

Dollars in thousands	2017	2016	2015
Insurance commissions	$4,005	$4,022	$4,042
Trust and wealth management fees	1,863	449	595
Service fees related to deposit accounts	6,643	4,370	4,285
Realized securities (losses) gains, net	(14)	1,127	1,444
Bank owned life insurance income	1,017	1,054	1,040
Other	913	578	455
Total	$14,427	$11,600	$11,861

Noninterest Expense

Noninterest expense totaled $57.7 million, $34.8 million and $33.6 million, or 2.9%, 2.2% and 2.3% of average assets for each of the years ended December 31, 2017, 2016 and 2015. Total noninterest expense increased $22.9 million in 2017 compared to 2016 and increased $1.2 million in 2016 compared to 2015. Our most notable changes in noninterest expense during 2017 were the increase in salaries, commissions and employee benefits, amortization of intangibles and the litigation settlement charge. Table IV below presents a summary of our noninterest expenses for the past 3 years and the related year-over-year changes in each such expense.

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Table IV - Noninterest Expense

Dollars in thousands	2017	Change $	Change %	2016	Change $	Change %	2015
Salaries, commissions and employee benefits	$25,075	$5,502	28.1 %	$19,573	$1,935	11.0 %	$17,638
Net occupancy expense	3,011	913	43.5 %	2,098	134	6.8 %	1,964
Equipment expense	3,954	1,195	43.3 %	2,759	465	20.3 %	2,294
Professional fees	1,367	(148)	(9.8)%	1,515	(101)	(6.3)%	1,616
Advertising and public relations	578	133	29.9 %	445	(52)	(10.5)%	497
Amortization of intangibles	1,410	1,163	470.9 %	247	47	23.5 %	200
FDIC premiums	1,065	190	21.7 %	875	(345)	(28.3)%	1,220
Merger-related expense	1,589	656	70.3 %	933	933	n/a	—
Foreclosed properties expense	611	197	47.6 %	414	(270)	(39.5)%	684
Gains on sales of foreclosed properties, net	(157)	759	(82.9)%	(916)	(890)	n/m	(26)
Write-downs of foreclosed properties	885	217	32.5 %	668	(1,747)	(72.3)%	2,415
Litigation settlement	9,900	9,900	n/m	—	—	— %	—
Other	8,457	2,266	36.6 %	6,191	1,061	20.7 %	5,130
Total	$57,745	$22,943	65.9 %	$34,802	$1,170	3.5 %	$33,632

Salaries, commissions and employee benefits: These expenses are 28% higher in 2017 compared to 2016 primarily due to general merit increases and an increase in our average annual full-time equivalent employees, primarily those in conjunction with the FCB and HCB acquisitions. The 11% increase in 2016 compared to 2015 was primarily due to general merit increases and an increase in our average annual full-time equivalent employees by 11, which included the increase attributable to the HCB acquisition.

Net occupancy expense: The 43.5% increase in 2017 is primarily due to the acquired FCB locations.

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

Amortization of intangibles: Amortization of intangibles increased during 2017 as a result of the additional amortization of the core deposit intangibles associated with the FCB and HCB acquisitions.

FDIC premiums: FDIC premiums increased 21.7% during 2017 as a result of the significant increase in our balance sheet due to recent acquisitions, partially offset by lower premium rates caused by the FDIC's change in the factors used to compute its deposit insurance rates, effective the second half of 2016. FDIC premiums decreased 28% during 2016 reflecting a revised methodology and lower rates for the premium calculation applicable during the second half of 2016. These lower effective premium rates are expected to continue.

Merger-related expense: These expenses are comprised of data processing conversion costs, employee severance costs, write-downs of equipment and legal fees related to the FCB and HCB acquisitions. Such costs are not expected to continue.

Foreclosed properties expense: Foreclosed properties expense increased for 2017 as a result of higher repairs and maintenance of foreclosed properties, as well as the expenses attributable to the properties acquired in conjunction with the FCB acquisition.

Gains on sales of foreclosed properties: Included in 2016 gains, were gains of $1.1 million related to sales of lots in two foreclosed residential subdivisions.

Write-downs of foreclosed properties: Management expects such write-downs to continue comparable to 2016 and 2017.

Litigation settlement: We recorded a $9.9 million pre-tax charge as full resolution of the ResCap Litigation which had been pending since 2014. See the Legal Contingencies section of Note 17 Commitments and Contingencies in the accompanying notes to consolidated financial statements.

Other: Other expenses increased $2.3 million during 2017 primarily due to increased general operating costs due to the acquisitions of FCB and HCB. Other expenses increased $1.1 million during 2016. The principal contributors to this increase included:

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- Deferred director compensation plan expenses increased $683,000. Under the plan, the directors optionally defer their director fees into a "phantom" investment plan whereby the company recognizes expense relative to the phantom return of each such investment. One such investment includes our common stock, the value of which increased 132% during 2016 and accounted for the principal reason for the increased cost of this plan;

- Debit card related expenses increased $153,000 due to increased card usage and increased third-party processing fees; and

- Mortgage warehouse lines of credit servicing fees of $288,000 were paid in conjunction with our new participation arrangement for such lines in 2016.

In addition, Summit recognized a $320,000 net gain on insurance proceeds in excess of related flood losses in 2016, which partially offsets other expenses.

Income Tax Expense

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was signed into law. Among other things, the TCJA permanently lowers the federal corporate income tax rate to 21% from the existing maximum rate of 35%, effective January 1, 2018. As a result of the reduction of the federal corporate income tax rate, U.S. generally accepted accounting principles require companies to remeasure their deferred tax assets and deferred tax liabilities, including those accounted for in accumulated other comprehensive income, as of the date of TCJA's enactment and record the effects as income tax expense in the reporting period of enactment.

We remeasured our deferred tax assets and deferred tax liabilities as of December 22, 2017, at the new federal corporate income tax rate of 21%, and recorded preliminary additional income tax expense of $3.5 million to reduce our net deferred tax assets.

Income tax expense for the years ended December 31, 2017, 2016 and 2015 totaled $9.7 million, $8.0 million and $6.9 million, respectively. Our effective tax rate (income tax expense as a percentage of income before taxes) for 2017, 2016 and 2015 were 44.8%, 31.6% and 30.0%, respectively. The 2017 increased effective tax rate was primarily due to the preliminary income tax expense adjustment resulting from the enactment of the TCJA. The 2016 increased effective tax rate was a result of the average balance of taxable earning assets (principally loans) having grown significantly while the average balance of tax-exempt earning assets remained relatively stable. Refer to Note 15 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

Our average assets increased during 2017 to $2.01 billion, an increase of 25.4% above 2016's average of $1.60 billion, and our year end December 31, 2017 assets were $375.6 million more than December 31, 2016. Average assets increased 9.1% in 2016, from $1.47 billion in 2015. Significant changes in the components of our balance sheet in 2017 and 2016 are discussed below.

Table V - Summary of Significant Changes in Financial Position 2017 versus 2016

Dollars in thousands	Balance December 31, 2016	Increase (Decrease) Impact of FCB Acquisition	Other Changes	Balance December 31, 2017
Assets				
Cash and cash equivalents	$46,616	$39,053	$(33,038)	$52,631
Securities available for sale	266,542	100,735	(38,554)	328,723
Other investments	12,942	582	1,410	14,934
Loans, net	1,307,862	225,743	60,139	1,593,744
Property held for sale	24,504	2,377	(5,411)	21,470
Premises and equipment	23,737	6,174	4,298	34,209
Goodwill and other intangibles	13,652	15,056	(1,195)	27,513
Cash surrender value of life insurance policies	39,143	1,509	706	41,358
Other assets	23,649	3,593	(7,584)	19,658
Total Assets	$1,758,647	$394,822	$(19,229)	$2,134,240
Liabilities				
Deposits	$1,295,519	$350,533	$(45,451)	$1,600,601
Short-term borrowings	224,461	7,309	18,729	250,499
Long-term borrowings	46,670	—	(919)	45,751
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	—	—	19,589
Other liabilities	17,048	3,853	(4,606)	16,295
Shareholders' Equity	155,360	33,127	13,018	201,505
Total liabilities and shareholders' equity	$1,758,647	$394,822	$(19,229)	$2,134,240

Table VI - Summary of Significant Changes in Financial Position 2016 versus 2015

Dollars in thousands	Balance December 31, 2015	Increase (Decrease) Impact of HCB Acquisition	Other Changes	Balance December 31, 2016
Assets				
Cash and cash equivalents	$9,487	$31,409	$5,720	$46,616
Securities available for sale	280,792	5,932	(20,182)	266,542
Other investments	8,949	—	3,993	12,942
Loans, net	1,079,331	60,847	167,684	1,307,862
Property held for sale	25,567	23	(1,086)	24,504
Premises and equipment	21,572	1,617	548	23,737
Goodwill and other intangibles	7,498	6,401	(247)	13,652
Cash surrender value of life insurance policies	37,732	351	1,060	39,143
Other assets	21,501	514	1,634	23,649
Total Assets	$1,492,429	$107,094	$159,124	$1,758,647
Liabilities				
Deposits	$1,066,709	$106,762	$122,048	$1,295,519

Short-term borrowings	171,394	—	53,067	224,461
Long-term borrowings	75,581	—	(28,911)	46,670
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	—	—	19,589
Other liabilities	15,412	332	1,304	17,048
Shareholders' Equity	143,744	—	11,616	155,360
Total liabilities and shareholders' equity	$1,492,429	$107,094	$159,124	$1,758,647

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Cash and Cash Equivalents

Cash and cash equivalents increased $6.0 million during 2017, primarily due to acquired interest bearing deposits with other banks related to the HCB acquisition.

Loan Portfolio

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

Table VII - Loans by Type

	2017		2016		2015		2014		2013	
Dollars in thousands	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Commercial	$190,270	11.8 %	$119,256	9.0 %	$97,324	8.9 %	$88,688	8.6 %	$88,405	9.3 %
Commercial real estate	737,961	45.8 %	586,014	44.4 %	541,388	49.6 %	475,343	46.0 %	430,804	45.3 %
Construction and development	101,022	6.3 %	89,069	6.7 %	75,648	6.9 %	96,630	9.4 %	86,712	9.1 %
Residential mortgage	500,720	31.1 %	406,293	30.8 %	346,380	31.7 %	340,269	33.0 %	321,541	33.8 %
Mortgage warehouse lines	30,757	1.9 %	85,963	6.5 %	—	— %	—	— %	—	— %
Consumer	36,302	2.3 %	25,524	1.9 %	19,297	1.8 %	19,500	1.9 %	19,900	2.1 %
Other	13,245	0.8 %	9,499	0.7 %	11,683	1.1 %	11,522	1.1 %	3,279	0.4 %
Total loans	$1,610,277	100.0%	$1,321,618	100.0%	$1,091,720	100.0%	$1,031,952	100.0%	$950,641	100.0%

Total net loans averaged $1.5 billion in 2017, which represented 75% of total average assets compared to $1.2 billion in 2016, or 74% of total average assets. A continued improving economic environment in our market area contributed to 9.6% organic loan growth, excluding mortgage warehouse lines, which declined $55 million in 2017, and purchased loans, in 2017, primarily in the commercial and non-owner occupied commercial real estate portfolios, following 2016's growth of 7.9% and 2015's growth of 5.7%.

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, 2017 and Note 3 for information regarding the volume of loans acquired in the FCB and HCB transactions.

In the normal course of business, we make various commitments and incur certain contingent liabilities, which are disclosed in Note 17 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 15.4% of total assets at December 31, 2017 compared to 15.2% at December 31, 2016. Average securities approximated $329.9 million for 2017 or 16.8% more than 2016's average of $282.4 million. We obtained $100.7 million of available for sale securities in the FCB acquisition; the portfolio was restructured by selling $94 million of those securities and only $54 million of the proceeds were reinvested. Refer to Note 5 of the accompanying consolidated financial statements for details of amortized cost, the estimated fair values,

unrealized gains and losses as well as the security classifications by type.

The following table presents the fair value of our securities portfolio by type at December 31, 2017, 2016 and 2015.

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Table VIII - Fair Value of Securities	December 31		
Dollars in thousands	2017	2016	2015
Available for Sale			
Taxable debt securities			
U.S. Government and agencies and corporations	$31,613	$15,174	$21,475
Residential mortgage-backed securities:			
Government-sponsored agencies	121,321	138,846	146,734
Nongovernment-sponsored entities	2,077	4,653	7,885
State and political subdivisions	17,677	—	1,953
Corporate debt securities	16,245	18,170	14,226
Total taxable debt securities	188,933	176,843	192,273
Tax-exempt debt securities			
State and political subdivisions	139,653	89,562	88,442
Total tax-exempt debt securities	139,653	89,562	88,442
Equity securities	137	137	77
Total available for sale securities	$328,723	$266,542	$280,792

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. 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 in the period of such determination.

At December 31, 2017, 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, 2017, together with the weighted average yields for each range of maturity, is summarized in Table VI. The stated average yields are stated on a tax equivalent basis.

Table IX - Securities Maturity Analysis

	Within one year		After one but within five years		After five but within ten years		After ten years	
(At amortized cost, dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U. S. Government agencies and corporations	$501	4.9%	$4,705	3.5%	$8,187	2.5%	$17,867	2.8%
Residential mortgage backed securities:								
Government sponsored agencies	37,187	3.1%	73,353	2.5%	8,153	2.8%	2,255	2.9%
Nongovernment sponsored entities	1,120	3.3%	856	3.9%	69	5.3%	—	— %
State and political subdivisions	720	3.7%	4,261	3.1%	19,602	3.0%	129,560	3.4%
Corporate debt securities	—	—	—	—	4,798	4.3%	11,577	5.1%
Other	—	—	—	—	—	—	137	—
Total	$39,528	3.2%	$83,175	2.6%	$40,809	3.0%	$161,396	3.5%

Deposits

Total deposits at December 31, 2017 increased $305.1 million or 23.5% compared to December 31, 2016. Deposits acquired in conjunction with the purchase of FCB totaled $350.0 million. In addition to acquired deposits, we have strengthened our focus on growing core transaction accounts. Excluding acquired deposits, core transaction accounts grew $46.9 million or 13.2% during 2017 while our internet-only high yielding savings product declined $38.4 million and direct CDs decreased $41.4 million as we were less aggressive on the pricing of these funds as there was more than ample funding and liquidity as result of the FCB acquisition.

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Table X - Deposits

Dollars in thousands	2017	2016	2015	2014	2013
Noninterest bearing demand	$217,493	$149,737	$119,010	$115,427	$92,837
Interest bearing demand	410,606	262,591	215,721	204,030	186,578
Savings	358,168	337,348	266,825	253,578	193,446
Time deposits	614,334	545,843	465,153	488,279	530,951
Total deposits	$1,600,601	$1,295,519	$1,066,709	$1,061,314	$1,003,812

See Table I for average deposit balance and rate information by deposit type for the past five years and Note 12 of the accompanying consolidated financial statements for a maturity distribution of time deposits as of December 31, 2017.

Borrowings

Lines of Credit: We have a remaining available line of credit from the Federal Home Loan Bank of Pittsburgh ("FHLB") totaling $486.1 million at December 31, 2017. We use this line 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 $176.6 million available on a short term line of credit with the Federal Reserve Bank at December 31, 2017, which is primarily secured by consumer loans, construction loans and commercial and industrial loans and a $6 million available line of credit with a correspondent bank.

Short-term Borrowings: Total short-term borrowings consisting primarily of advances from the FHLB having original maturities of 30 days or less increased $26.0 million from $224.5 million at December 31, 2016 to $250.5 million at December 31, 2017. See Note 13 of the accompanying consolidated financial statements for additional disclosures regarding our short-term borrowings.

Long-term Borrowings: Long-term borrowings historically have been used to fund our loan growth, however, as a result of prolonged low short-term interest rates following the economic downturn of 2008, long-term borrowings have been reduced significantly as we have replaced maturing long-term borrowings with short-term funding. Total long-term borrowings of $45.8 million at December 31, 2017 and $46.7 million at December 31, 2016 consisted primarily of structured repurchase agreements with unaffiliated institutions. Long-term borrowings from the FHLB totaled $751,000 at December 31, 2017, compared to $767,000 outstanding at December 31, 2016. During 2007, we entered into $110 million of structured 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. These structured repurchase agreements totaled $45.0 million at December 31, 2017. Refer to Note 13 of the accompanying consolidated financial statements for additional information regarding our long-term borrowings.

ASSET QUALITY

For purposes of this discussion, we define nonperforming assets to include foreclosed properties, other repossessed assets and nonperforming loans, which is comprised of loans 90 days or more past due and still accruing interest and nonaccrual loans. Performing troubled debt restructurings ("TDRs") are excluded from nonperforming loans.

Table VIII presents a summary of nonperforming assets at December 31, as follows:

Table XI - Nonperforming Assets					
Dollars in thousands	2017	2016	2015	2014	2013
Accruing loans past due 90 days or more					
Commercial	$—	$—	$—	$—	$—
Commercial real estate	237				
Residential construction & development	—	—	—	—	—
Residential real estate	—	—	—	—	—
Consumer	37	—	9	—	—
Other	—	—	—	—	—
Total accruing loans 90+ days past due	274	—	9	—	—
Nonaccrual loans					
Commercial	696	298	853	392	1,224
Commercial real estate	2,927	4,845	5,955	1,844	2,318
Commercial construction & development	—	—	—	—	3,782
Residential construction & development	3,569	4,465	5,623	4,619	9,048
Residential real estate	7,656	4,815	3,245	5,556	2,446
Consumer	201	151	83	83	128
Total nonaccrual loans	15,049	14,574	15,759	12,494	18,946
Foreclosed properties					
Commercial	—	—	—	110	—
Commercial real estate	1,789	1,749	1,300	5,204	9,903
Commercial construction & development	7,392	8,610	8,717	10,179	11,125
Residential construction & development	11,182	13,265	14,069	19,267	20,485
Residential real estate	1,107	880	1,481	2,769	11,879
Total foreclosed properties	21,470	24,504	25,567	37,529	53,392
Repossessed assets	68	12	5	221	8
Total nonperforming assets	$36,861	$39,090	$41,340	$50,244	$72,346
Total nonperforming loans as a percentage of total loans	0.95 %	1.10 %	1.45 %	1.21 %	1.99 %
Total nonperforming assets as a percentage of total assets	1.73 %	2.22 %	2.77 %	3.48 %	5.22 %
Allowance for loan losses as a percentage of nonperforming loans	82.00 %	80.10 %	72.75 %	89.38 %	66.82 %
Allowance for loan losses as a percentage of period end loans	0.78 %	0.88 %	1.05 %	1.08 %	1.33 %

Refer to Note 7 for information regarding our past due loans, impaired loans, nonaccrual loans and troubled debt restructurings.

We monitor our concentrations in higher-risk lending areas in accordance with the Interagency Guidance for Concentrations in Commercial Real Estate Lending issued in 2006. This guidance establishes concentration guidelines of 100% of Tier 1 Capital plus the allowance for loan and lease loss for lending in construction, land development and other land loans. It further establishes a guideline of 300% of Tier 1 Capital plus the allowance for loan and lease loss for lending in construction, land development and other land loans plus loans secured by non-owner occupied non-farm non-residential properties. As of December 31, 2017, Summit Community Bank was within the recommended limits of 100% and 300%, respectively.

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

losses is provided in Note 8 of the accompanying financial statements.

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

In analyzing the relationship between the allowance for loan losses, net loan charge-offs and nonperforming loans, it is helpful to understand the process of how loans are treated as they deteriorate over time. Reserves for loans are established at origination through the quantitative and qualitative reserve process discussed above based upon credit quality.

Charge-offs, if necessary, are typically recognized in a period after the reserves were established. If the previously established reserves exceed that needed to satisfactorily resolve the problem credit, a reduction in the overall level of the reserve could be

recognized. In summary, if loan quality deteriorates, the typical credit sequence consists of periods of expense recognition, followed by periods of charge-offs.

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

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

Substantially all of our nonperforming loans are secured by real estate. The majority of these loans were underwritten in accordance with our loan-to-value policy guidelines which range from 70-85% at the time of origination. Although $8.0 million of our nonperforming loans have a related allowance of $1.5 million, the fair values of the underlying collateral value or the discounted cash flows remain in excess of the recorded investment in many of our nonperforming loans and therefore, no specific reserve allocation is required.

At December 31, 2017 and 2016, our allowance for loan losses totaled $12.6 million, or 0.78% of total loans and $11.7 million, or 0.88% of total loans, respectively. If the acquired FCB and HCB loans are excluded, the allowance for loan losses to total loans ratio at December 31, 2017 and 2016 would have been 0.91% and 0.92%, respectively. The allowance for loan losses is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio. The 2017 decline as a percentage of total loans is a result of lower average loan losses experienced. Lower losses cause our historical charge-off factor of the quantitative reserve calculation to decline, thus requiring fewer quantitative reserves. Also contributing to this decline are purchased loans. Purchased loans are recorded on the balance sheet at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses. Instead, the applicable fair value adjustment relative to each purchased loan includes a discount to provide for future, life-of-loan estimated credit losses at the date of acquisition.

Due to the loan portfolio acquired in conjunction with the FCB acquisition having a higher relative percentage of contractually past due loans than that of Summit’s legacy portfolio, we experienced an overall increase in loans past due at December 31, 2017 (see Note 6 of the accompanying Notes to the Consolidated Financial Statements). These past due loans were recorded at fair value, which included a discount as applicable for each such loan’s estimated future credit losses at the time of acquisition; accordingly, these increased levels of past due loans did not significantly impact the balance of our allowance for loan losses at December 31, 2017.

Table XII presents an allocation of the allowance for loan losses by loan type at each respective year end date, as follows:

Table XII - Allocation of the Allowance for Loan Losses

	2017			2016			2015			2014			2013		
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	$1,303	11.8	%	$934	9.0	%	$781	8.9	%	$1,204	8.6	%	$1,323	9.3	%

Commercial real estate	7,374	45.8	%	5,547	44.4	%	4,566	49.6	%	2,244	46.0	%	1,610	45.3	%
Construction and development	794	6.3	%	2,287	6.7	%	2,867	6.9	%	3,844	9.4	%	5,724	9.1	%
Residential real estate	2,621	31.1	%	2,682	30.8	%	3,099	31.7	%	3,547	33.0	%	3,904	33.8	%
Mortgage warehouse lines	—	1.9	%	—	6.5	%	—	—	%	—	—	%	—	—	%
Consumer	210	2.3	%	121	1.9	%	59	1.8	%	97	1.9	%	48	2.1	%
Other	263	0.8	%	103	0.7	%	100	1.1	%	231	1.1	%	50	0.4	%
Total	$12,565	100.0	%	$11,674	100.0	%	$11,472	100.0	%	$11,167	100.0	%	$12,659	100.0	%

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A reconciliation of the activity in the allowance for loan losses follows:
Table XIII - Allowance for Loan Losses

Dollars in thousands	2017	2016	2015	2014	2013
Balance, beginning of year	$11,674	$11,472	$11,167	$12,659	$17,933
Losses					
Commercial	23	489	77	390	723
Commercial real estate	70	303	737	11	1,040
Construction and development	36	136	457	3,535	3,596
Residential real estate	519	344	701	514	5,359
Mortgage warehouse lines	—	—	—	—	—
Consumer	389	98	69	265	79
Other	251	185	110	118	162
Total	1,288	1,555	2,151	4,833	10,959
Recoveries					
Commercial	124	73	10	34	12
Commercial real estate	180	48	303	358	682
Construction and development	278	840	456	298	187
Residential real estate	164	145	206	254	138
Mortgage warehouse lines	—	—	—	—	—
Consumer	82	76	105	74	79
Other	101	75	126	73	87
Total	929	1,257	1,206	1,091	1,185
Net losses	359	298	945	3,742	9,774
Provision for loan losses	1,250	500	1,250	2,250	4,500
Balance, end of year	$12,565	$11,674	$11,472	$11,167	$12,659
Net losses as a % of average loans	0.02 %	0.02 %	0.09 %	0.38 %	1.02 %

At December 31, 2017 and 2016, we had approximately $21.5 million and $24.5 million, respectively, in property held for sale which was obtained as the result of foreclosure proceedings. Although foreclosed property is recorded at the lower of investment in the real estate or fair value less estimated costs to sell, the prices ultimately realized upon their sale may or may not result in us recognizing loss.

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 excess funds at correspondent banks, non-pledged securities and available lines of credit with the FHLB, Federal Reserve Bank of Richmond and correspondent banks, which totaled approximately $894.6 million or 41.9% of total consolidated assets at December 31, 2017.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit activity. As a member of the FHLB, we have access to borrow approximately $733.9 million. At December 31, 2017, we had available borrowing capacity of $486.1 million on our FHLB line. We also maintain a credit line with the Federal Reserve Bank of Richmond as a contingency liquidity vehicle. The amount available on this line at December 31, 2017 was approximately $177 million, which is secured by a pledge of our consumer loans, construction loans and commercial and industrial loan portfolios. We have a $6 million unsecured line of credit with a correspondent bank. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises. During 2017, our loan growth was funded by deposits as our loans increased approximately $286.8 million, while total deposits

increased $305.1 million.

Liquidity risk represents the risk of loss due to the possibility that funds may not be available to satisfy current or future commitments based on external market issues, customer or creditor perception of financial strength and events unrelated to Summit such as war, terrorism, or financial institution market specific issues. The Asset/Liability Management Committee ("ALCO"), comprised of members of senior management and certain members of the Board of Directors, oversees our liquidity risk management process. The ALCO develops and recommends policies and limits governing our liquidity to the Board of

Directors for approval with the objective of ensuring that we can obtain cost-effective funding to meet current and future obligations, as well as maintain sufficient levels of on-hand liquidity, under both normal and "stressed" circumstances.
Refer to page 15 of Item 1A. Risk Factors for further discussion of our liquidity risk.

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 2017, we spent approximately $6.2 million on capital expenditures for premises and equipment. We expect our capital expenditures to approximate $6 - $7 million in 2018, primarily for new branch sites and construction and equipment and technological upgrades.

Absent an acquisition, management anticipates 5-7% organic asset growth in 2018.

Capital Compliance: Our capital position is strong. Stated as a percentage of total assets, our equity ratio was 9.4% at December 31, 2017 compared to 8.8% at December 31, 2016. 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 $61.7 million, $41.5 million and $91.3 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 19 of the accompanying consolidated financial statements for further discussion of our regulatory capital.

On April 1, 2017, we issued 1,537,912 shares of common stock, valued at $33.1 million, in conjunction with the acquisition of FCB. Further, we retained $6.4 million of earnings during 2017 and the net change in accumulated other comprehensive income was $5.0 million, principally resulting from $2.7 million net gains on securities available for sale and $1.6 million in net gains on cash flow hedges.

On July 30, 2015, our Employee Stock Ownership Plan ("ESOP") purchased 225,000 shares of Summit Financial Group Inc. common stock, which is shown as a reduction of shareholders' equity, similar to a purchase of treasury stock. When the shares are committed to be released and become available for allocation to plan participants, the then fair value of such shares will be charged to compensation expense. Unallocated shares owned by the Company's ESOP are not considered to be outstanding for the purpose of computing earnings per share.

Dividends: Cash dividends per share totaled $0.44 and $0.40 during 2017 and 2016, respectively, representing dividend payout ratios of 44.0% and 24.7%, respectively. It is our intention to continue to pay dividends on a quarterly basis during 2018. Future dividend amounts will depend on the earnings and financial condition of our subsidiary bank 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 law and regulations and require 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. In addition, cash dividends depend on the earnings and financial condition of our subsidiary bank and our capital adequacy as well as general economic conditions. During 2018, the net retained profits available for distribution to Summit as dividends without regulatory approval are approximately $20.4 million.

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, 2017.

Table XIV - Contractual Cash Obligations

Dollars in thousands	Long Term Debt and Subordinated Debentures	Operating Leases
2018	$ 45,017	$ 269
2019	18	200
2020	18	53
2021	19	31
2022	21	—
Thereafter	20,247	106
Total	$ 65,340	$ 659

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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, 2017 are presented in the following table. Refer to Note 17 of the accompanying consolidated financial statements for further discussion of our off-balance sheet arrangements.

Table XV - Off-Balance Sheet Arrangements

Dollars in thousands	
Commitments to extend credit	
Revolving home equity and credit card lines	$69,187
Construction loans	44,323
Other loans	112,193
Standby letters of credit	3,870
Total	$229,573

QUARTERLY FINANCIAL DATA

A summary of our selected quarterly financial data is as follows:

	2017			
Dollars in thousands, except per share amounts	First Quarter (A)	Second Quarter	Third Quarter	Fourth Quarter (B)
Interest income	$17,674	$22,231	$22,036	$22,587
Net interest income	13,630	17,848	17,232	17,438
Net income	(1,616)	5,278	5,930	2,323
Basic earnings per share	$(0.15)	$0.43	$0.48	$0.19
Diluted earnings per share	$(0.15)	$0.43	$0.48	$0.19

	2016			
Dollars in thousands, except per share amounts	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$15,165	$15,283	$15,906	$17,737
Net interest income	11,779	11,734	12,037	13,457
Net income	4,063	4,243	4,281	4,710
Basic earnings per share	$0.38	$0.40	$0.40	$0.44
Diluted earnings per share	$0.38	$0.40	$0.40	$0.44

(A) Includes $6.2 million or $0.52 per diluted share after-tax charge related to litigation settlement.
(B) Includes $3.5 million or $0.29 per diluted share preliminary charge to income taxes due to enactment of TCJA.

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 the Board of Directors and of members of senior management. The ALCO actively formulates the economic assumptions that we use in our financial planning and budgeting process and establishes policies which control and monitor our sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position at December 31, 2017 is slightly liability sensitive over the next twelve months, however we are asset sensitive thereafter. The nature of our lending and funding activities tends to drive our interest rate risk position to being 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, except for the up 400 scenario, which assumes a gradual increase in rates over 24 months. Assumptions used to project yields and rates for new loans and deposits are derived from historical analysis. Securities portfolio maturities and prepayments are reinvested in like instruments. Mortgage loan prepayment assumptions are developed from industry estimates of prepayment speeds. Noncontractual deposit repricings are modeled on historical patterns.

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of December 31, 2017. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable thereafter for the down 100 and the up 200 scenarios and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above.

Change in Interest Rates	Estimated % Change in Net Interest Income over:	
	0 - 12 Months	13 - 24 Months
Down 100 basis points (1)	0.03 %	0.91 %
Up 200 basis points (1)	-1.14 %	-2.39 %
Up 400 basis points (2)	-0.43 %	-0.39 %

(1) assumes a parallel shift in the yield curve over 12 months
(2) assumes a parallel shift in the yield curve over 24 months

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. Yount, Hyde & Barbour, P.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, 2017. 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) in 2013. Based on this assessment, management concludes that, as of December 31, 2017, its system of internal control over financial reporting is effective and meets the criteria of the Internal Control-Integrated Framework. Yount, Hyde & Barbour, P.C., independent registered public accounting firm, has issued an attestation report on 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.

/s/ H. Charles Maddy, III	/s/ Robert S. Tissue	/s/ Julie R. Markwood
President and Chief Executive Officer	Senior Vice President and Chief Financial Officer	Vice President and Chief Accounting Officer

Moorefield, West Virginia
March 1, 2018

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

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

Opinion on the Internal Control over Financial Reporting
We have audited Summit Financial Group, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.
We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended of the Company and our report dated March 2, 2018 expressed an unqualified opinion.
Basis for Opinion
The Company'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 in the accompanying Report of 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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.
We conducted our audit in accordance with the standards of the PCAOB. 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.
Definition and Limitations of Internal Control over Financial Reporting
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 principles. 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 may 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.

Winchester, Virginia

March 2, 2018

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Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Summit Financial Group, Inc. and subsidiaries (the Company) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 2, 2018 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2016.

Winchester, Virginia
March 2, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated statements of income, comprehensive income, shareholders' equity and cash flows of Summit Financial Group, Inc. and subsidiaries, for the year ended December 31, 2015. 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 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 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Summit Financial Group, Inc. and subsidiaries for the year ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

Charleston, West Virginia
February 26, 2016

Consolidated Balance Sheets

	December 31,	
Dollars in thousands	2017	2016
ASSETS		
Cash and due from banks	$9,641	$4,262
Interest bearing deposits with other banks	42,990	42,354
Cash and cash equivalents	52,631	46,616
Securities available for sale	328,723	266,542
Other investments	14,934	12,942
Loans held for sale	—	176
Loans, net	1,593,744	1,307,862
Property held for sale	21,470	24,504
Premises and equipment, net	34,209	23,737
Accrued interest receivable	8,329	6,167
Goodwill and other intangible assets	27,513	13,652
Cash surrender value of life insurance policies	41,358	39,143
Other assets	11,329	17,306
Total assets	$2,134,240	$1,758,647
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Non-interest bearing	$217,493	$149,737
Interest bearing	1,383,108	1,145,782
Total deposits	1,600,601	1,295,519
Short-term borrowings	250,499	224,461
Long-term borrowings	45,751	46,670
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589
Other liabilities	16,295	17,048
Total liabilities	1,932,735	1,603,287
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, $1.00 par value, authorized 250,000 shares	—	—
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares; issued: 2017 - 12,465,296 shares, 2016 - 10,883,509 shares; outstanding: 2017 - 12,358,562 shares, 2016 - 10,736,970 shares	81,098	46,757
Unallocated common stock held by Employee Stock Ownership Plan - 2017 - 106,734 shares, 2016 - 146,539 shares	(1,152)	(1,583)
Retained earnings	119,827	113,448
Accumulated other comprehensive income (loss)	1,732	(3,262)
Total shareholders' equity	201,505	155,360
Total liabilities and shareholders' equity	$2,134,240	$1,758,647

See Notes to Consolidated Financial Statements

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Consolidated Statements of Income

	For the Year Ended December 31,		
Dollars in thousands (except per share amounts)	2017	2016	2015
Interest income			
Interest and fees on loans			
Taxable	$74,365	$56,439	$51,554
Tax-exempt	543	541	514
Interest and dividends on securities			
Taxable	5,071	4,395	4,329
Tax-exempt	3,939	2,543	2,479
Interest on interest bearing deposits with other banks	609	173	7
Total interest income	84,527	64,091	58,883
Interest expense			
Interest on deposits	11,210	8,964	8,336
Interest on short-term borrowings	4,473	2,288	525
Interest on long-term borrowings and subordinated debentures	2,697	3,832	4,006
Total interest expense	18,380	15,084	12,867
Net interest income	66,147	49,007	46,016
Provision for loan losses	1,250	500	1,250
Net interest income after provision for loan losses	64,897	48,507	44,766
Noninterest income			
Insurance commissions	4,005	4,022	4,042
Trust and wealth management fees	1,863	449	595
Service fees related to deposit accounts	6,643	4,370	4,285
Realized securities (losses) gains, net	(14)	1,127	1,444
Bank owned life insurance income	1,017	1,054	1,040
Other	913	578	455
Total noninterest income	14,427	11,600	11,861
Noninterest expenses			
Salaries, commissions and employee benefits	25,075	19,573	17,638
Net occupancy expense	3,011	2,098	1,964
Equipment expense	3,954	2,759	2,294
Professional fees	1,367	1,515	1,616
Advertising and public relations	578	445	497
Amortization of intangibles	1,410	247	200
FDIC premiums	1,065	875	1,220
Merger-related expenses	1,589	933	—
Foreclosed properties expense	611	414	684
Gain on sales of foreclosed properties, net	(157)	(916)	(26)
Write-downs of foreclosed properties	885	668	2,415
Litigation settlement	9,900	—	—
Other	8,457	6,191	5,130
Total noninterest expenses	57,745	34,802	33,632
Income before income tax expense	21,579	25,305	22,995
Income tax expense	9,664	8,008	6,893
Net income	$11,915	$17,297	$16,102
Basic earnings per common share	$1.00	$1.62	$1.56

Diluted earnings per common share	$1.00	$1.61	$1.50

See Notes to Consolidated Financial Statements

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Consolidated Statements of Comprehensive Income

	For the Year Ended December 31,		
Dollars in thousands	2017	2016	2015
Net income	$11,915	$17,297	$16,102
Other comprehensive income (loss):			
Net unrealized gain (loss) on cashflow hedges of:			
2017 - $2,556, net of deferred taxes of $946; 2016 - $459, net of deferred taxes of $170; 2015 - ($2,160), net of deferred taxes of ($799)	1,610	289	(1,361)
Net unrealized gain (loss) on securities available for sale of:			
2017 - $4,378, net of deferred taxes of $1,620 and reclassification adjustment for net realized losses included in net income of ($14), net of tax of ($5)	2,758		
2016 - ($4,913), net of deferred taxes of ($1,818) and reclassification adjustment for net realized gains included in net income of $1,127, net of tax of $417		(3,095)	
2015 - ($1,852), net of deferred taxes of ($685) and reclassification adjustment for net realized gains included in net income of $1,444, net of tax of $534			(1,167)
Net unrealized gain on other post-retirement benefits of:			
2017- $521, net of deferred taxes of $193	328	—	—
Total other comprehensive income (loss)	4,696	(2,806)	(2,528)
Total comprehensive income	$16,611	$14,491	$13,574

See Notes to Consolidated Financial Statements

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Consolidated Statements of Shareholders' Equity
For the Years Ended December 31, 2017, 2016 and 2015

Dollars in thousands (except per share amounts)	Series 2009 Preferred Stock and Related Surplus	Series 2011 Preferred Stock and Related Surplus	Common Stock and Related Surplus	Unallocated Common Stock Held by ESOP	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2014	$ 3,419	$ 5,764	$ 32,670	$ —	$ 87,719	$ 2,072	$ 131,644
Net income	—	—	—	—	16,102	—	16,102
Other comprehensive loss						(2,528)	(2,528)
Exercise of stock options - 6,560 shares	—	—	51	—	—	—	51
Share-based compensation expense	—	—	151	—	—	—	151
Conversion of Series 2009 Preferred Stock to common stock	(3,419)	—	3,404	—	—	—	(15)
Conversion of Series 2011 Preferred Stock to common stock	—	(5,764)	5,747	—	—	—	(17)
Issuance of 493,920 shares of common stock	—	—	4,705	—	—	—	4,705
Purchase of unallocated common stock of 208,333 shares held by ESOP	—	—	—	(2,250)	—	—	(2,250)
Unallocated ESOP shares committed to be released - 26,511 shares	—	—	26	286	—	—	312
Purchase and retirement of 100,000 shares of common stock	—	—	(1,080)	—	—	—	(1,080)
Common stock issuances from reinvested dividends - 5,745 shares	—	—	67	—	—	—	67
Common stock cash dividends declared ($0.32 per share)	—	—	—	—	(3,398)	—	(3,398)
Balance, December 31, 2015	—	—	45,741	(1,964)	100,423	(456)	143,744
Net income	—	—	—	—	17,297	—	17,297
Other comprehensive loss						(2,806)	(2,806)
Exercise of stock options - 24,740 shares	—	—	447	—	—	—	447
Share-based compensation expense	—	—	200	—	—	—	200
Unallocated ESOP shares committed to be released - 35,283 shares	—	—	268	381	—	—	649
Common stock issuances from reinvested dividends - 5,203 shares	—	—	101	—	—	—	101
Common stock cash dividends declared ($0.40 per share)	—	—	—	—	(4,272)	—	(4,272)
Balance, December 31, 2016	—	—	46,757	(1,583)	113,448	(3,262)	155,360
Net income	—	—	—	—	11,915	—	11,915
Other comprehensive income						4,696	4,696
Reclassification of tax effects due to change in U.S. corporate tax rate	—	—	—	—	(298)	298	—
	—	—	304	—	—	—	304

Exercise of stock options - 18,340 shares							
Share-based compensation expense	—	—	385	—	—	—	385
Unallocated ESOP shares committed to be released - 39,805 shares	—	—	515	431	—	—	946
Acquisition of First Century Bankshares, Inc. - 1,537,912 shares, net of issuance costs	—	—	32,968	—	—	—	32,968
Common stock issuances from reinvested dividends - 6,950 shares	—	—	169	—	—	—	169
Common stock cash dividends declared ($0.44 per share)	—	—	—	—	(5,238)	—	(5,238)
Balance, December 31, 2017	$—	$—	$81,098	$ (1,152)	$119,827	$ 1,732	$201,505

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Consolidated Statements of Cash Flows

	For the Year Ended December 31,		
Dollars in thousands	2017	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$11,915	$17,297	$16,102
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,887	1,224	1,076
Provision for loan losses	1,250	500	1,250
Share-based compensation expense	385	200	151
Deferred income tax expense (benefit)	4,076	(357)	190
Loans originated for sale	(16,248)	(10,593)	(4,762)
Proceeds from sale of loans	16,747	11,425	4,606
Gains on loans held for sale	(323)	(229)	(96)
Realized securities losses (gains), net	14	(1,127)	(1,444)
Gain on disposal of assets	(133)	(946)	(24)
Write-downs of foreclosed properties	885	668	2,415
Amortization of securities premiums, net	4,190	4,325	5,131
(Accretion) amortization related to acquisitions, net	(1,051)	(44)	12
Amortization of intangibles	1,410	247	200
(Increase) decrease in accrued interest receivable	(1,102)	(254)	293
Earnings on bank owned life insurance	(707)	(1,059)	(1,032)
Decrease (increase) in other assets	668	(894)	(1,077)
Increase in other liabilities	510	2,827	657
Net cash provided by operating activities	24,373	23,210	23,648
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturities and calls of securities available for sale	2,700	3,235	2,043
Proceeds from sales of securities available for sale	152,882	72,453	69,632
Principal payments received on securities available for sale	31,902	35,881	38,502
Purchases of securities available for sale	(148,174)	(99,497)	(113,677)
Purchases of other investments	(18,604)	(18,273)	(9,997)
Proceeds from redemptions of other investments	15,932	14,066	7,231
Net loan originations	(61,104)	(170,716)	(63,359)
Purchases of premises and equipment	(6,185)	(1,857)	(2,588)
Proceeds from disposal of premises and equipment	—	43	—
Proceeds from sale of repossessed assets & property held for sale	5,567	4,705	13,224
Cash and cash equivalents acquired in acquisition, net of $14,989 cash consideration paid - 2017, net of $21,826 cash consideration paid - 2016	39,053	31,409	—
Net cash provided by (used in) investing activities	13,969	(128,551)	(58,989)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in demand deposit, NOW and savings accounts	48	78,462	28,487
Net (decrease) increase in time deposits	(45,261)	43,575	(23,125)
Net increase in short-term borrowings	18,729	53,068	47,761
Repayment of long-term borrowings	(918)	(28,911)	(1,909)
Repayment of subordinated debt	—	—	(16,800)
Net proceeds from issuance of common stock	10	101	4,772
Purchase and retirement of common stock	—	—	(1,080)
Purchase of unallocated common stock held by ESOP	—	—	(2,250)
Exercise of stock options	303	447	51
Dividends paid on common stock	(5,238)	(4,272)	(3,398)

Dividends paid on preferred stock	—	—	(191)
Net cash (used in) provided by financing activities	(32,327)	142,470	32,318
Increase (decrease) in cash and cash equivalents	6,015	37,129	(3,023)
Cash and cash equivalents:			
Beginning	46,616	9,487	12,510
Ending	$52,631	$46,616	$9,487

See Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows - continued

Dollars in thousands	For the Year Ended December 31, 2017	2016	2015
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash payments for:			
Interest	$18,201	$15,175	$12,854
Income taxes	$5,996	$8,022	$7,440
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES			
Real property and other assets acquired in settlement of loans	$430	$2,394	$2,622

See Note 3 regarding noncash transactions included in the acquisitions.

See Notes to Consolidated Financial Statements

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NOTE 1. BASIS OF PRESENTATION

We are a financial holding company headquartered in Moorefield, West Virginia. We operate in three business segments: community banking, trust and wealth management services and insurance services. Our primary business is community banking. Our community bank subsidiary, Summit Community Bank ("Summit Community") provides commercial and retail banking services primarily in the Eastern Panhandle and Southern regions of West Virginia and the Northern, Shenandoah Valley and Southwestern regions of Virginia. We also operate Summit Insurance Services, LLC in Moorefield, West Virginia and Leesburg, Virginia.

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Use of estimates: We must make estimates and assumptions that affect the reported amounts and disclosures in preparing our financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Summit and its wholly-owned subsidiaries. All significant accounts and transactions among these entities have been eliminated.

Comprehensive income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale, cash flow hedges and other post-retirement benefits, which are recognized as separate components of equity.

Cash and cash equivalents: Cash and cash equivalents includes cash on hand, amounts due from banks (including cash items in process of clearing), interest bearing deposits with other banks and federal funds sold.

Loans held for sale: Loans held for sale are valued at the lower of aggregate carrying cost or fair value. Gains or losses realized on the sales of loans are recognized in other income at the time of sale.

Cash surrender value of life insurance policies: We have purchased life insurance policies on certain employees. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Presentation of cash flows: For purposes of reporting, cash flows from demand deposits, NOW accounts, savings accounts and short-term borrowings are reported on a net basis, since their original maturities are less than three months. Cash flows from loans and certificates of deposit and other time deposits are reported net.

Advertising: Advertising costs are expensed as incurred.

Trust services: Assets held in an agency or fiduciary capacity are not our assets and are not included in the accompanying consolidated balance sheets. Trust services income is recognized on the cash basis in accordance with customary banking practice. Reporting such income on a cash basis does not produce results that are materially different from those that would result from use of the accrual basis.

Unconsolidated subsidiary trusts: In accordance with accounting principles generally accepted in the United States, we do not consolidate subsidiary trusts which issue guaranteed preferred beneficial interests in subordinated debentures (Trust Preferred Securities). The Trust Preferred Securities continue to qualify as Tier 1 capital for regulatory purposes. See Note 13 of our Notes to Consolidated Financial Statements for a discussion of our

subordinated debentures owed to unconsolidated subsidiary trusts.

Significant accounting policies: The following table identifies our other significant accounting policies and the Note and page where a detailed description of each policy can be found.

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NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers: Topic 606. This ASU revised guidance for the recognition, measurement, and disclosure of revenue from contracts with customers. The original guidance has been amended through subsequent accounting standard updates that resulted in technical corrections, improvements, and a one-year deferral of the effective date to January 1, 2018. The guidance, as amended, is applicable to all entities and, once effective, will replace significant portions of existing industry and transaction-specific revenue recognition rules with a more principles-based recognition model. Most revenue associated with financial instruments, including interest income, loan origination fees, and credit card fees, is outside the scope of the guidance. Gains and losses on securities, derivatives, and sales of financial instruments are similarly excluded from the scope. While we have concluded the adoption of ASU 2014-09 will not have a material impact on our consolidated financial statements, it will result in expanded disclosures related to non-interest income and enhance the qualitative disclosures on the revenues within the scope of the new guidance.
ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee‘s obligation to make lease payments arising

from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. While we are currently assessing the impact of the adoption of this pronouncement, we expect the primary impact to our

consolidated financial position upon adoption will be the recognition, on a discounted basis, of our minimum commitments under non-cancellable operating leases on our consolidated balance sheets resulting in the recording of right of use assets and lease obligations. Our current minimum commitments under long-term operating leases are disclosed in Note 17, Commitments and Contingencies.
During June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments. The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. We will adopt the guidance by the first quarter of 2020 with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. In this regard, we have thus far formed a cross-functional implementation team comprised of personnel from risk management, operations and information technology, loan administration and finance and engaged a third-party to assist us. The implementation team has developed a project plan and is staying informed about the broader industry's perspectives and insights, and is identifying and researching key decision points. We will soon prepare a readiness assessment and gap analysis relative to required data which will serve to direct our areas of focus. We will continue to evaluate the impact the new standard will have on our consolidated financial statements as the final impact will be dependent, among other items, upon the loan portfolio composition and credit quality at the adoption date, as well as economic conditions, financial models used and forecasts at that time.
During August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments, to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The amendments are to be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. We do not expect the adoption of ASU 2016-15 to have a material impact on our financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805) - Clarifying the Definition of a Business. The amendments in this ASU clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Under the current implementation guidance in Topic 805, there are three elements of a business-inputs, processes and outputs. While an integrated set of assets and activities (collectively referred to as a “set”) that is a business usually has outputs, outputs are not required to be present. In addition, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs. The amendments in this ASU provide a screen to determine when a set is not a business. If the screen is not met, the amendments (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The ASU provides a framework to assist entities in evaluating whether both an input and a substantive process are present. The amendments in this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The amendments in this ASU are to be applied prospectively on or after the effective date. No disclosures are required at transition. We do not expect the adoption of ASU 2017-01 to have a material impact on our financial statements.

In March of 2017, the FASB issued ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. This guidance shortens the amortization period for premiums on certain callable debt securities to the earliest call date (with an explicit, noncontingent call

feature that is callable at a fixed price and on a preset date), rather than contractual maturity date as currently required under GAAP. The ASU does not impact instruments without preset call dates such as mortgage-backed securities. For instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the ASU. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. The adoption of the new pronouncement will not have an impact on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, that provides guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The guidance is effective for fiscal years, and interim

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

In February 2018, the FASB issued ASU No. 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The deferred tax asset and liability valuation adjustment as a result of the change in enacted federal tax rate is required to be included in income from continuing operations even in situations in which the related income tax effects of the items in accumulated other comprehensive income were originally recognized in other comprehensive income. The pronouncement permits reporting entities to reclass the stranded tax effects from the Tax Cuts and Jobs Act from accumulated other comprehensive income to retained earnings. The pronouncement is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Upon early adoption of this pronouncement, we recorded a reclassification of $298,000, which is disclosed in Note 22. Accumulated Other Comprehensive Income (Loss).

NOTE 3. ACQUISITIONS

First Century Bankshares, Inc.

On April 1, 2017, Summit Community Bank, Inc. ("SCB"), a wholly-owned subsidiary of Summit, acquired 100% of the ownership of First Century Bankshares, Inc. ("FCB") and its subsidiary First Century Bank, headquartered in Bluefield, West Virginia. Partnering with FCB not only expanded Summit's community banking footprint into southwest West Virginia and southwestern Virginia, it also notably provided us the opportunity to offer trust services throughout our Bank's market area, a capability which we previously did not possess. Pursuant to the Agreement and Plan of Merger dated June 1, 2016, FCB's shareholders received cash in the amount of $22.50 per share or 1.2433 shares of Summit common stock, or a combination of cash and Summit stock, subject to proration to result in approximately 35% cash and 65% stock consideration in the aggregate. Total stock consideration was $33.1 million or 1,537,912 shares of Summit common stock and cash consideration was $15.0 million. FCB's assets and liabilities approximated $406 million and $361 million, respectively, at March 31, 2017.

The assets and liabilities of FCB were recorded at their respective acquisition date fair values. Determining the fair value of assets and liabilities, particularly related to the loan portfolio, is a complicated process involving significant judgment regarding methods and assumptions used to calculate the estimated fair values. The fair values are preliminary and subject to refinement for up to one year after the acquisition date as additional information relative to the acquisition date fair values becomes available. We recognized preliminary goodwill of $4.25 million in connection with the acquisition (not deductible for income tax purposes), which is not amortized for financial reporting purposes but is subject to annual impairment testing. The core deposit intangible represents the value of long-term deposit relationships acquired in this transaction and will be amortized over an estimated weighted average life of 15 years using an accelerated method which approximates the estimated run-off of the acquired deposits. The following table details the total consideration paid on April 1, 2017 in connection with the acquisition of FCB, the fair values of the

assets acquired and liabilities assumed and the resulting preliminary goodwill.

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Dollars in thousands	As Recorded by FCB	Estimated Fair Value Adjustments	Estimated Fair Values as Recorded by Summit
Cash consideration			$ 14,989
Stock consideration			33,127
Total consideration			48,116
Identifiable assets acquired:			
Cash and cash equivalents	$ 54,042	$ —	$ 54,042
Securities available for sale, at fair value	101,022	295	101,317
Loans			
Purchased performing	224,809	(2,693)	222,116
Purchased credit impaired	4,167	(540)	3,627
Allowance for loan losses	(2,511)	2,511	—
Premises and equipment	10,396	(4,222)	6,174
Property held for sale	4,596	(2,219)	2,377
Goodwill	5,183	(5,183)	—
Core deposit intangibles	—	10,916	10,916
Other assets	4,450	652	5,102
Total identifiable assets acquired	406,154	(483)	405,671
Identifiable liabilities assumed:			
Deposits	349,726	807	350,533
Other liabilities	11,216	58	11,274
Total identifiable liabilities assumed	360,942	865	361,807
Net identifiable assets acquired	$ 45,212	$ (1,348)	$ 43,864
Preliminary goodwill resulting from acquisition			$ 4,252

The following is a description of the methods used to determine the fair values of significant assets and liabilities in both the FCB and HCB acquisitions.

Cash and cash equivalents: The carrying amount of these assets approximates their fair value based on the short-term nature of these assets.

Securities: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair value estimates are based on observable inputs including quoted market prices for similar instruments, quoted market prices that are not in an active market or other inputs that are observable in the market.

Loans: Fair values for loans are based on a discounted cash flow methodology that considered factors including the type of loan and related collateral, collectibility, fixed or variable interest rate, term of loan, amortization status and current market rates. Loans were grouped together according to similar characteristics and were treated in the aggregate when applying various valuation techniques. The discount rates used for loans are based on current market rates for new originations of comparable loans and include adjustments for liquidity concerns, if any.

Premises and equipment: The fair value of FCB's real property was determined based upon appraisals by licensed appraisers. The fair value of tangible personal property, which is not material, was assumed to equal the carrying value by FCB.

Property held for sale: The fair value of FCB's property held for sale was determined on a property by property basis based upon the lessor of the properties present asking price or its appraised value by licensed appraisers, less estimated costs to sell.

Core deposit intangible: This intangible asset represents the value of the relationships with deposit customers. The fair value was estimated based on a discounted cash flow methodology that gave appropriate consideration to expected customer attrition rates, cost of the deposit base, reserve requirements and the net maintenance cost attributable to customer deposits.

Deposits: The fair values of the demand and savings deposits by definition equal the amount payable on demand at the acquisition date. The fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered to the contractual interest rates on such time deposits.

Loans acquired in a business combination are recorded at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses. Purchased credit-impaired (PCI) loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments. When determining fair value, PCI loans are identified as of the date of acquisition based upon evidence of credit quality such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments of principal and interest at acquisition and the cash flows expected to be collected at acquisition is accounted for as a "nonaccretable difference". For purposes of determining the nonaccretable difference, no prepayments are generally assumed in determining contractually required payments of principal and interest or cash flows expected to be collected. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent significant increases in cash flows may result in a reversal of the provision for loan losses to the extent of prior charges, or a transfer from nonaccretable difference to accretable yield. Further, any excess of cash flows expected at acquisition over the amount paid is the accretable yield and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

Loans not designated PCI loans as of the acquisition date are designated as purchased performing loans. We account for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses is recorded for any additional deterioration in these loans subsequent to the acquisition.

The PCI loan portfolio acquired in the FCB acquisition was recorded at estimated fair value on the date of acquisition, April 1, 2017, as follows:

Dollars in thousands	Acquired Loans -PCI
Contractual principal and interest due	$ 4,885
Nonaccretable difference	(597)
Expected cash flows	4,288
Accretable yield	(661)
Purchase credit impaired loans - estimated fair value	$ 3,627

Highland County Bankshares, Inc.

On October 1, 2016, Summit Community Bank, Inc. ("SCB"), a wholly-owned subsidiary of Summit, acquired 100% of the ownership of Highland County Bankshares, Inc. ("HCB") and its subsidiary First and Citizens Bank, headquartered in Monterey, Virginia. With this transaction, Summit expanded its footprint into the Virginia counties of Highland, Bath and Augusta, each of which are contiguous with counties where Summit has existing offices. Pursuant to the Agreement and Plan of Merger dated February 29, 2016, HCB's shareholders received $38.00 for each share of HCB common stock they owned, or approximately $21.8 million in the aggregate. HCB's assets and liabilities

approximated $123 million and $107 million, respectively, at September 30, 2016.

We recognized goodwill of $4.82 million in connection with the acquisition (deductible for income tax purposes), which is not amortized for financial reporting purposes but is subject to annual impairment testing. The core deposit intangible represents the value of long-term deposit relationships acquired in this transaction and will be amortized over an estimated weighted average life of 16 years using an accelerated method which approximates the estimated run-off of the acquired deposits. The following table details the total consideration paid on October 1, 2016 in connection with the acquisition of HCB, the fair values of the assets acquired and liabilities assumed and the resulting goodwill.

(Dollars in thousands)	As Recorded by HCB	Estimated Fair Value Adjustments	Estimated Fair Values as Recorded by Summit
Cash consideration paid			$21,826
Identifiable assets acquired:			
Cash and cash equivalents	$53,235	$ —	$53,235
Securities available for sale, at fair value	5,932	—	5,932
Loans			
Purchased performing	58,931	(467)	58,464
Purchased credit impaired	2,910	(528)	2,382
Allowance for loan losses	(1,040)	1,040	—
Premises and equipment	1,925	(307)	1,618
Property held for sale	41	(18)	23
Core deposit intangibles	—	1,612	1,612
Other assets	906	(41)	865
Total identifiable assets acquired	$122,840	$ 1,291	$124,131
Identifiable liabilities assumed:			
Deposits	106,907	(112)	106,795
Other liabilities	332	—	332
Total identifiable liabilities assumed	$107,239	$ (112)	$107,127
Net identifiable assets acquired	$15,601	$ 1,403	$17,004
Goodwill resulting from acquisition			$4,822

The PCI loan portfolio related to the HCB acquisition was accounted for at estimated fair value on the date of acquisition, October 1, 2016, as follows:

Dollars in thousands	Acquired Loans -PCI
Contractual principal and interest due	$3,301
Nonaccretable difference	(586)
Expected cash flows	2,715
Accretable yield	(333)
Purchase credit impaired loans - estimated fair value	$2,382

Pro Forma Results of Operations

The following table estimates the pro forma revenue, net income and diluted earnings per share of the combined entities of Summit, FCB and HCB as if the acquisitions had taken place on January 1, 2015. The pro forma revenue, net income and diluted earnings per share combines the historical results of FCB and HCB with Summit's consolidated statements of income for the periods below and, while certain adjustments were made for the estimated effect of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisitions actually taken place on January 1, 2015. Acquisition related expenses of $1,589,000 and $933,000 were included in our actual consolidated statements of income for the years ended December 31, 2017 and 2016, but were excluded from the pro forma information listed below. Additionally, HCB

incurred acquisition related expenses of $405,000 in 2016 which were also excluded. In addition and also excluded, was a 2016 charge of $5.46 million by FCB relative to the termination of its defined benefit plan, which was required in conjunction with the merger. We expect to achieve operational cost savings and other efficiencies as a result of the acquisitions which are not reflected in the pro forma amounts below.

	Summit, FCB & HCB Pro Forma For the Year Ended December 31,		
Dollars in thousands	2017	2016	2015
Total revenues, net of interest expense	$85,470	$82,634	$81,706
Net income	$13,029	$20,312	$18,915
Diluted earnings per share	$1.09	$1.66	$1.54

It is impracticable for us to provide total revenue, net income and diluted earnings per share attributable to the operations of FCB and HCB that were included in our consolidated statement of income from April 1, 2017 (date of FCB acquisition) and October 1, 2016 (date of FCB acquisition) through December 31, 2017, since their operations were merged and fully integrated into Summit's bank subsidiary operations upon acquisition and meaningful financial information relative to those operations is not available.

The following presents the financial effects of adjustments recognized in the statements of income for the years ended December 31, 2017 and 2016 related to business combinations that occurred during 2017 or 2016.

	Income increase (decrease)	
Dollars in thousands	December 31, 2017	December 31, 2016
Interest and fees on loans	$825	$ 66
Interest expense on deposits	237	(10)
Amortization of intangibles	(1,210)	(47)
Income before income tax expense	$(148)	$ 9

NOTE 4. FAIR VALUE MEASUREMENTS

Fair value is based upon the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy is utilized to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs used to measure fair value are as follows:

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

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

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

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

assets.

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

Available-for-Sale Securities: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Certain trust preferred securities classified as corporate debt securities are Level 3 due to limited market trades of these classes of securities.

Derivative Financial Instruments: Derivative financial instruments are recorded at fair value on a recurring basis. Fair value measurement is based on pricing models run by a third-party, utilizing observable market-based inputs. All future floating cash flows are projected and both floating and fixed cash flows are discounted to the valuation date. As a result, we classify interest rate swaps as Level 2.

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

Loans: We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the original contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the discounted cash flows or collateral value exceeds the recorded investments in such loans. These loans are carried at recorded loan investment and therefore are not included in the following tables of loans measured at fair value. Impaired loans internally graded as substandard, doubtful, or loss are evaluated using the fair value of collateral method. All other impaired loans are measured for impairment using the discounted cash flows method. Impaired loans where an allowance is established based on the fair value of collateral are included in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When a current appraised value is not available and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

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

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

consolidated statements of income.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

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Dollars in thousands	Balance at December 31, 2017	Fair Value Measurements Using: Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$ 31,613	$ —	$ 31,613	$ —
Mortgage backed securities:				
Government sponsored agencies	121,321	—	121,321	—
Nongovernment sponsored entities	2,077	—	2,077	—
State and political subdivisions	17,677	—	17,677	—
Corporate debt securities	16,245	—	16,245	—
Other equity securities	137	—	137	—
Tax-exempt state and political subdivisions	139,653	—	139,653	—
Total available for sale securities	$ 328,723	$ —	$ 328,723	$ —
Derivative financial assets				
Interest rate swaps	$ 312	$ —	$ 312	$ —
Derivative financial liabilities				
Interest rate swaps	$ 2,057	$ —	$ 2,057	$ —

Dollars in thousands	Balance at December 31, 2016	Fair Value Measurements Using: Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$ 15,174	$ —	$ 15,174	$ —
Mortgage backed securities:				
Government sponsored agencies	138,846	—	138,846	—
Nongovernment sponsored entities	4,653	—	4,653	—
Corporate debt securities	18,170	—	18,170	—
Other equity securities	137	—	137	—
Tax-exempt state and political subdivisions	89,562	—	89,562	—
Total available for sale securities	$ 266,542	$ —	$ 266,542	$ —
Derivative financial assets				
Interest rate swaps	$ 200	$ —	$ 200	$ —
Derivative financial liabilities				
Interest rate swaps	$ 4,611	$ —	$ 4,611	$ —

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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

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Dollars in thousands	Balance at December 31, 2017	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$ —	$ —	$ —	$ —
Collateral-dependent impaired loans				
Commercial real estate	$ 518	$ —	$ 518	$ —
Construction and development	940	—	940	—
Residential real estate	203	—	203	—
Total collateral-dependent impaired loans	$ 1,661	$ —	$ 1,661	$ —
Property held for sale				
Commercial real estate	$ 1,493	$ —	$ 1,493	$ —
Construction and development	16,177	—	16,177	—
Residential real estate	322	—	322	—
Total property held for sale	$ 17,992	$ —	$ 17,992	$ —

Dollars in thousands	Balance at December 31, 2016	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$ 176	$ —	$ 176	$ —
Collateral-dependent impaired loans				
Construction and development	$ 945	$ —	$ 945	$ —
Residential real estate	130	—	130	—
Total collateral-dependent impaired loans	$ 1,075	$ —	$ 1,075	$ —
Property held for sale				
Commercial real estate	$ 976	$ —	$ 976	$ —
Construction and development	19,327	—	19,327	—
Residential real estate	279	—	279	—
Total property held for sale	$ 20,582	$ —	$ 20,582	$ —

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

Cash and cash equivalents: The carrying values of cash and cash equivalents approximate their estimated fair value.

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

Other investments: Other investments consists of FHLB stock, which does not have readily determinable fair values and is carried at cost and an investment in a limited partnership which owns interests in a diversified portfolio of qualified affordable housing projects which is reflected at its carrying value.

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

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

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

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

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

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

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

Derivative financial instruments: The fair value of the interest rate swaps is valued using independent pricing models.

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

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

	At December 31				
	2017		Fair Value Measurements Using:		
Dollars in thousands	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$52,631	$52,631	$—	$52,631	$—
Securities available for sale	328,723	328,723	—	328,723	—
Other investments	14,934	14,934	—	14,934	—
Loans held for sale, net	—	—	—	—	—
Loans, net	1,593,744	1,592,821	—	1,661	1,591,160
Accrued interest receivable	8,329	8,329	—	8,329	—
Derivative financial assets	312	312	—	312	—
	$1,998,673	$1,997,750	$—	$406,590	$1,591,160
Financial liabilities					
Deposits	$1,600,601	$1,620,033			