

SUMMIT FINANCIAL GROUP INC

Form 10-K

March 14, 2006

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, 2005**

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 (I.R.S. Employer
jurisdiction of Identification No.)
incorporation or
organization)

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

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

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

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

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

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

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Indicate by check mark whether the registrant: (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant at June 30, 2005, was approximately \$171,827,000. The number of shares of the Registrant's Common Stock outstanding on March 9, 2006, was 7,126,220. (Registrant has assumed that all of its executive officers and directors are affiliates. Such assumption shall not be deemed to be conclusive for any other purpose.)

Documents Incorporated by Reference

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

Part of Form 10-K into which

Document document is incorporated

Portions of the Registrant's Part I - Items 1, 2, 3, 5, and 9A

2005 Annual Report to Shareholders Part II - Items 6, 7, 7A, and 8

Portions of the Registrant's Proxy Statement for the Part III - Items 10, 11, 12, 13, and 14
Annual Meeting of Shareholders to be held May 18, 2006

SUMMIT FINANCIAL GROUP, INC

Form 10-K Index

Page

PART I.

Item 1. Business	3-9
------------------	-----

Item 1A. Risk Factors	10
-----------------------	----

Item 2. Properties	11
--------------------	----

Item 3. Legal Proceedings	12
---------------------------	----

Item 4. Submission of Matters to a Vote of Shareholders	12
--	----

PART II.

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchase of Equity Securities	13
---	----

Item 6. Selected Financial Data	13
---------------------------------	----

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	13
---	----

Item 7A. Quantitative and Qualitative Disclosures about Market Risk	13
--	----

Item 8. Financial Statements and Supplementary Data	13
--	----

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	14
--	----

Item 9A. Controls and Procedures	14
----------------------------------	----

Item 9B. Other Information	14
----------------------------	----

PART III.

Item 10. Directors and Executive Officers of the15
Registrant

Item 11. Executive Compensation 15

Item 12. Security Ownership of Certain Beneficial
Owners
and Management and Related Shareholder Matters 15

Item 13. Certain Relationships and Related15
Transactions

Item 14. Principal Accounting Fees and Services 15

PART IV.

Item 15. Exhibits, Financial Statement Schedules 16-17

SIGNATURES 18

FORWARD-LOOKING INFORMATION

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

PART I.

Item 1. Business

General

Summit Financial Group, Inc. (“Company” or “Summit”) is a \$1.1 billion financial holding company headquartered in Moorefield, West Virginia. We operate two major business segments, community banking and mortgage banking. Our community banking segment provides commercial and retail banking services primarily in the Eastern Panhandle and South Central regions of West Virginia and the Northern region of Virginia. We provide these services through our two community bank subsidiaries: Summit Community Bank (“Summit Community”), and Shenandoah Valley National Bank (“Shenandoah”) (collectively, the “Bank Subsidiaries”). Our mortgage banking segment originates loans to customers throughout the United States from its headquarters in Chesapeake, Virginia. This entity, formerly known as Summit Financial, LLC, began operating as Summit Mortgage, a division of Shenandoah Valley National Bank during first quarter 2005. We also operate Summit Insurance Services, LLC in Moorefield, West Virginia. Our segmented financial information for 2005, 2004, and 2003 is set forth in the tables in Note 16 of the notes of the accompanying consolidated financial statements and a discussion of this information is in the Management’s Discussion and Analysis section of our 2005 annual report and is incorporated herein by reference.

Community Banking

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

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

Our primary lending focus is providing commercial loans to local businesses with annual sales ranging from \$300,000 to \$30 million and providing owner-occupied real estate loans to individuals. Typically, our customers have financing requirements between \$50,000 and \$1,000,000. We generally do not seek loans of more than \$5 million, but will consider larger lending relationships which involve exceptional levels of credit quality. Under our commercial banking strategy, we focus on offering a broad line of financial products and services to small and medium-sized businesses through full service banking offices. Each Bank Subsidiary has senior management with extensive lending experience. These managers exercise substantial authority over credit and pricing decisions, subject to loan committee approval for larger credits. This decentralized management approach, coupled with continuity of service by the same

staff members, enables the Bank Subsidiaries to develop long-term customer relationships, maintain high quality service and respond quickly to customer needs. We believe that our emphasis on local relationship banking, together with a conservative approach to lending, are important factors in our success and growth. We centralize operational and support functions that are transparent to customers in order to achieve consistency and cost efficiencies in the delivery of products and services by each banking office. The central office provides services such as data processing, bookkeeping, accounting, treasury management, loan administration, loan review, compliance, risk management and internal auditing to enhance our delivery of quality service. We also provide overall direction in the areas of credit policy and administration, strategic planning, marketing, investment portfolio management and other financial and administrative services. The banking offices work closely with us to develop new products and services needed by their customers and to introduce enhancements to existing products and services.

Mortgage Banking

Our mortgage banking segment originates for resale: 1) primarily residential second mortgage debt consolidation loans to customers throughout the United States marketed utilizing direct mail to customers with reasonably good credit histories who desire to reduce their credit card and other consumer debts by obtaining second mortgage debt-consolidation loans; and 2) traditional residential first mortgage loans to borrowers in West Virginia and northern Virginia.

Supervision and Regulation

General

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

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

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

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

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

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

The operations of Shenandoah, as a national banking association, are subject to federal statutes and regulations which apply to national banks, and are primarily regulated by the Comptroller of Currency (“OCC”). Summit Community is subject to similar West Virginia statutes and regulations, and is primarily regulated by the West Virginia Division of Banking. The Bank Subsidiaries are also subject to regulations promulgated by the FRB and the FDIC. As members of the FDIC, the deposits of the Bank Subsidiaries are insured as required by federal law. Bank regulatory authorities

regularly examine revenues, loans, investments, management practices, and other aspects of the Bank Subsidiaries. These examinations are conducted primarily to protect depositors and not shareholders. In addition to these regular examinations, the Bank Subsidiaries must furnish to regulatory authorities quarterly reports containing full and accurate statements of their affairs.

Permitted Non-banking Activities

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

Credit and Monetary Policies and Related Matters

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

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

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

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

Capital Requirements

As a financial holding company, we are subject to FRB risk-based capital guidelines. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations, takes off-balance sheet exposures into explicit account in assessing capital adequacy, and minimizes disincentives to holding liquid, low-risk assets. Under the guidelines and related policies, financial holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance

sheet commitments into four weighted categories, with higher levels of capital being required for categories perceived as representing greater risk. The Bank Subsidiaries are subject to substantially similar capital requirements adopted by its applicable regulatory agencies.

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

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

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

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

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

Our regulatory capital ratios and each of the Bank Subsidiaries' capital ratios as of year end 2005 are set forth in the table in Note 15 of the notes to the consolidated financial statements in the *Financial Information* section of our 2005 *Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Federal Deposit Insurance Corporation Improvement Act of 1991

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

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

significantly undercapitalized and critically undercapitalized.

By regulation, an institution is "well-capitalized" if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater and a Tier 1 leverage ratio of 5% or greater and is not subject to a regulatory order, agreement or directive to meet and maintain a specific capital level for any capital measure. Each of the Bank Subsidiaries were "well capitalized" institutions as of December 31, 2005. As well-capitalized institutions, they are permitted to engage in a wider range of banking activities, including among other things, the accepting of "brokered deposits," and the offering of interest rates on deposits higher than the prevailing rate in their respective markets.

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

Reigle-Neal Interstate Banking Bill

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

Community Reinvestment Act

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

In the most recent CRA examinations by the applicable bank regulatory authorities, each of the Bank Subsidiaries was given "satisfactory" or better CRA ratings.

Graham-Leach-Bliley Act of 1999

The enactment of the Graham-Leach-Bliley Act of 1999 (the "GLB Act") represents a pivotal point in the history of the financial services industry. The GLB Act swept away large parts of a regulatory framework that had its origins in the Depression Era of the 1930s. Effective March 11, 2000, new opportunities were available for banks, other depository institutions, insurance companies and securities firms to enter into combinations that permit a single financial services organization to offer customers a more complete array of financial products and services. The GLB Act provides a new regulatory framework through the financial holding company, which have as its "umbrella regulator" the FRB. Functional regulation of the financial holding company's separately regulated subsidiaries are conducted by their primary functional regulators. The GLB Act makes a CRA rating of satisfactory or above necessary for insured

depository institutions and their financial holding companies to engage in new financial activities. The GLB Act also provides a Federal right to privacy of non-public personal information of individual customers.

Deposit Acquisition Limitation

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

Consumer Laws and Regulations

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

Sarbanes-Oxley Act of 2002

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

Competition

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

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

Employees

At February 28, 2006, we employed 276 full-time equivalent employees.

Available Information

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

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

Statistical Information

The information noted below is provided pursuant to Guide 3 - Statistical Disclosure by Bank Holding Companies. Page references are to the Annual Report to Shareholders for the year ended December 31, 2005, which portions have been filed as an exhibit to this Form 10-K and are incorporated herein by reference.

Description of Information	Page Reference
1. Distribution of Assets, Liabilities, and Shareholders' Equity; Interest Rates and Interest Differential	
a. Average Balance Sheets	6
b. Analysis of Net Interest Earnings	5
c. Rate Volume Analysis of Changes in Interest Income and Expense	7
2. Investment Portfolio	
a. Book Value of Investments	12
b. Maturity Schedule of Investments	12
c. Securities of Issuers Exceeding 10% of Shareholders' Equity	12
3. Loan Portfolio	
a. Types of Loans	11
b. Maturities and Sensitivity to Changes in Interest Rates	34
c. Risk Elements	13
d. Other Interest Bearing Assets	n/a
4. Summary of Loan Loss Experience	15
5. Deposits	
a. Breakdown of Deposits by Categories, Average Balance, and Average Rate Paid	6
b. Maturity Schedule of Time Certificates of Deposit and Other Time Deposits of \$100,000 or More	36
6. Return of Equity and Assets	2
7. Short-term Borrowings	37

Item 1A. Risk Factors

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

Market Price Fluctuations

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

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

Government Regulation

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

Interest Rate Risk

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

Credit Risk

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

Competition

We face aggressive competition not only from banks, but also from other financial institutions, including finance companies and credit unions, and, to a limited degree, from other providers of financial services, such as money market mutual funds, brokerage firms, and consumer finance companies. A number of competitors in our market areas are larger than we are and have substantially greater access to capital and other resources, as well as larger lending limits and branch systems, and offer a wider array of banking services. Many of our non-bank competitors are not

subject to the same extensive regulations that govern us. As a result, these non-bank competitors have advantages over us in providing certain services. Our profitability depends upon our ability to attract loans and deposits. There is a risk that aggressive competition could result in our controlling a smaller share of our markets. A decline in market share could adversely affect our results of operations and financial condition.

Growth and Capital

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

Key Personnel

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

Other

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

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

Our principal executive office is located at 300 North Main Street, Moorefield, West Virginia in a building that we own. Additionally, the Bank Subsidiaries' headquarters and branch locations occupy offices which are either owned or operated under long-term lease arrangements. At December 31, 2005, our Bank Subsidiaries operated 14 banking offices and Summit Mortgage operated 2 mortgage origination offices as follows:

Subsidiary / 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
Shenandoah Valley National Bank			

Winchester, Virginia	1	1	2
Leesburg, Virginia	-	1	1
Harrisonburg, Virginia	-	2	2
Warrenton, Virginia	-	1	1
Summit Mortgage			
Herndon, Virginia	-	1	1
Chesapeake, Virginia	-	1	1

We believe that the premises occupied by us and the Bank Subsidiaries generally are well-located and suitably equipped to serve as financial services facilities. See Notes 6 and 7 of our consolidated financial statements in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Item 3. Legal Proceedings

Information required by this item is set forth under the caption "Litigation" in Note 13 of our consolidated financial statements in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Item 4. Submission of Matters to a Vote of Shareholders

No matters were submitted during the fourth quarter of 2005 to a vote of Company shareholders.

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

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

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005				
Dividends paid	\$ -	\$ 0.14	\$ -	\$ 0.16
High Bid	36.00	33.49	33.55	28.00
Low Bid	26.51	23.82	25.54	22.48
2004				
Dividends paid	\$ -	\$ 0.125	\$ -	\$ 0.135
High Bid	17.75	20.38	21.75	29.75
Low Bid	17.28	17.00	19.55	21.38

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

As of March 1, 2006, there were approximately 1,367 shareholders of record of Summit's common stock.

Purchases of Summit Equity Securities: No purchases of our own equity securities, either as part of a publicly announced plan or otherwise, were made during any month of the fourth quarter 2005.

Item 6. Selected Financial Data

Information required by this item is set forth under the heading "SELECTED FINANCIAL DATA" in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

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

Information required by this item is set forth under the heading "MANAGEMENT'S DISCUSSION AND ANALYSIS" in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Information required by this item is set forth under the caption "MARKET RISK MANAGEMENT" in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data

Information required by this item is set forth under the headings "QUARTERLY FINANCIAL INFORMATION", "REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON CONSOLIDATED FINANCIAL STATEMENTS", "CONSOLIDATED FINANCIAL STATEMENTS" and "NOTES TO CONSOLIDATED FINANCIAL STATEMENTS" in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Disclosure Controls and Procedures: Our management, including the Chief Executive Officer and Chief Financial Officer, have conducted as of December 31, 2005, an evaluation of the effectiveness of disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of December 31, 2005 were effective.

Management's Report on Internal Control Over Financial Reporting: Information required by this item is set forth under the heading "REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING" in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Attestation Report of the Registered Public Accounting Firm: Information required by this item is set forth under the heading "REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING" in the *Financial Information* section of our *2005 Annual Report*, portions of which are attached hereto as Exhibit 13 and incorporated herein by reference.

Changes in Internal Control Over Financial Reporting: There were no changes in our internal control over financial reporting during the fourth quarter for the year ended December 31, 2005, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

On March 4, 2005, Summit Financial Group, Inc. (the "Company") entered into an Employment Agreement (the "Employment Agreement") and a new Change in Control Agreement (the "Change in Control Agreement") with H. Charles Maddy, III, the President and Chief Executive Officer of the Company. The term of the Employment Agreement is three years, commencing on March 4, 2005, and ending on March 4, 2008. Under the terms of the Employment Agreement, the Company will review the Employment Agreement annually, and may, with the approval of Mr. Maddy, extend the term of the Employment Agreement annually for additional one year periods.

At its meeting on December 6, 2005, the Compensation and Nominating Committee of the Board of Directors of the Company extended Mr. Maddy's Employment Agreement for an additional year until March 4, 2009. Mr. Maddy approved this extension.

PART III.**Item 10. Directors and Executive Officers**

Information required by this item is set forth under the captions “Section 16(a) Beneficial Ownership Reporting Compliance”, under the headings “NOMINEES FOR DIRECTOR WHOSE TERMS EXPIRE IN 2009”, “DIRECTORS WHOSE TERMS EXPIRE IN 2008”, and “DIRECTORS WHOSE TERMS EXPIRE IN 2007”, “EXECUTIVE OFFICERS” and under the caption “Audit and Compliance Committee” in our *2006 Proxy Statement*, and is incorporated herein by reference.

We have adopted a Code of Ethics that applies to our chief executive officer, chief financial officer, chief accounting officer, and all directors, officers and employees. We have posted this Code of Ethics on our internet website at www.summitfgi.com under “Governance Documents”. Any amendments to or waivers from any provision of the Code of Ethics applicable to the chief executive officer, chief financial officer, or chief accounting officer will be disclosed by timely posting such information on our internet website.

There have been no material changes to the procedures by which shareholders may recommend nominees since the disclosure of the procedures in our 2005 proxy statement.

Item 11. Executive Compensation

Information required by this item is set forth under the headings “COMPENSATION OF NAMED EXECUTIVE OFFICERS”, “INFORMATION REGARDING LONG-TERM INCENTIVE COMPENSATION FOR FISCAL YEAR 2005”, “SUMMARY OF COMPENSATION AGREEMENTS”, “REPORT OF THE COMPENSATION AND NOMINATING COMMITTEE ON EXECUTIVE COMPENSATION”, and “SHAREHOLDER RETURN PERFORMANCE GRAPH”, and under the caption “Fees and Benefit Plans for Directors” in our *2006 Proxy Statement*, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The following table provides information on our stock option plan as of December 31, 2005.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (#)	Weighted-average exercise price of outstanding options, warrants and rights (\$)	Number of securities remaining available for future issuance under equity compensation plans (#)
Equity compensation plans approved by stockholders	361,740	\$ 17.41	556,100
Equity compensation plans not approved by	-	-	-

stockholders

Total	361,740	\$ 17.41	556,100
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The remaining information required by this item is set forth under the caption “Security Ownership of Directors and Officers” and under the headings “NOMINEES FOR DIRECTOR WHOSE TERMS EXPIRE IN 2009”, “DIRECTORS WHOSE TERMS EXPIRE IN 2008”, “DIRECTORS WHOSE TERMS EXPIRE IN 2007”, “PRINCIPAL SHAREHOLDER” and “EXECUTIVE OFFICERS” in our *2006 Proxy Statement*, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

Information required by this item is set forth under the caption “Related Transactions” in our *2006 Proxy Statement*, and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

Information required by this item is set forth under the caption “Fees to Arnett & Foster, PLLC” in our *2006 Proxy Statement*, and is incorporated herein by reference.

PART IV.**Item 15. Exhibits, Financial Statement Schedules**

All financial statements and financial statement schedules required to be filed by this Form or by Regulation S-X, which are applicable to the Registrant, have been presented in the financial statements and notes thereto in Item 8 in Management's Discussion and Analysis of Financial Condition and Results of Operation in Item 7 or elsewhere in this filing where appropriate. The listing of exhibits follows:

Exhibit Number	Description	Page(s) in Form 10-K or Prior Filing Reference
(3)	Articles of Incorporation and By-laws: (i) Amendment to Articles of Incorporation of Summit Financial Group, Inc. dated May 14, 2004 (ii) Articles of Incorporation of Summit Financial Group, Inc. as last amended on August 17, 2004 (iii) By-laws of Summit Financial Group, Inc. as last amended, effective February 21, 2003	
(10)	Material Contracts (i) Employment Agreement with H. Charles Maddy, III (ii) Change in Control Agreement with H. Charles Maddy, III (iii) Employment Agreement with Ronald F. Miller (iv) Employment Agreement with C. David Robertson (v) Employment Agreement with Patrick N. Frye (v) Employment Agreement with Robert S. Tissue (v) Employment Agreement with Scott C. Jennings (vi) Employment Agreement with Douglas T. Mitchell (vii) 1998 Officers Stock Option Plan (viii) Board Attendance and Compensation Policy, as amended (ix) Summary of Compensation Paid to Executive Officers of Summit Financial Group, Inc. and Amendments to Executive Agreement (x) Summit Financial Group, Inc. Directors Deferral Plan	(a) (b) (c) (d) (e) (e) (e) (e) (f) (g)

(xi) Amendment No. 1 to Directors
Deferral Plan Agreement
(xii) Summit Financial Group, Inc.
Incentive Plan
(xiii) Shenandoah Valley National Bank
Incentive Plan
(xiv) Summit Community Bank
Incentive Compensation Plan

- (12) Statements Re: Computation of Ratios
- (13) Portions of 2005 Annual Report to
Shareholders
incorporated by reference into this Form
10-K
- (21) Subsidiaries of Registrant
- (23) Consent of Arnett & Foster, P.L.L.C.
- (24) Power of Attorney
- (31.1) Sarbanes-Oxley Act Section 302
Certification of Chief Executive Officer
- (31.2) Sarbanes-Oxley Act Section 302
Certification of Chief Financial Officer
- (32.1) Sarbanes-Oxley Act Section 906
Certification of Chief Executive Officer
- (32.2) Sarbanes-Oxley Act Section 906
Certification of Chief Financial Officer

- (a) Incorporated by reference to Exhibit 10.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated March 4, 2005.
- (b) Incorporated by reference to Exhibit 10.2 of Summit Financial Group, Inc.'s filing on Form 8-K dated March 4, 2005.
- (c) Incorporated by reference to Exhibit 10(ii) of South Branch Valley Bancorp, Inc.'s filing on Form 10-KSB dated December 31, 1998.
- (d) Incorporated by reference to Exhibit 10 of South Branch Valley Bancorp, Inc.'s filing on Form 10-QSB dated June 30, 1999.
- (e) Incorporated by reference to Exhibit 10.1 of Summit Financial Group, Inc. filing on Form 8-K dated December 30, 2005
- (f) Incorporated by reference to Exhibit 10 of South Branch Valley Bancorp, Inc.'s filing on Form 10-QSB dated June 30, 1998.
- (g) Incorporated by reference to Summit Financial Group, Inc.'s filing on Form 8-K dated December 6, 2005.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SUMMIT FINANCIAL GROUP, INC.
a West Virginia Corporation
(registrant)

By: /s/ H. Charles Maddy, III 3/14/2006
H. Charles Maddy, III Date
President & Chief Executive Officer

By: /s/ Julie R. Cook 3/14/06
Julie R. Cook Date
Vice President &
Chief Accounting Officer

By: /s/ Robert S. Tissue 3/14/2006
Robert S. Tissue Date
Senior Vice President &
Chief Financial Officer

The Directors of Summit Financial Group, Inc. executed a power of attorney appointing Robert S. Tissue and/or Julie R. Cook their attorneys-in-fact, empowering them to sign this report on their behalf.

By: /s/ Robert S. Tissue 3/14/2006
Robert S. Tissue Date
Attorney-in-fact