

1ST SOURCE CORP  
Form 10-Q  
October 22, 2015  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q  
(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-6233

(Exact name of registrant as specified in its charter)

INDIANA

35-1068133

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

100 North Michigan Street

South Bend, IN

46601

(Address of principal executive offices)

(Zip Code)

(574) 235-2000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

Number of shares of common stock outstanding as of October 16, 2015 — 26,082,147 shares

---

Table of Contents

TABLE OF CONTENTS

|  | Page   |
|--|--------|
| <br><u>PART I. FINANCIAL INFORMATION</u>   |        |
| <u>Item 1. Financial Statements (Unaudited)</u>  |        |
| <u>Consolidated Statements of Financial Condition — September 30, 2015 and December 31, 2014</u>                 | 3      |
| <u>Consolidated Statements of Income — three and nine months ended September 30, 2015 and 2014</u>               | 4      |
| <u>Consolidated Statements of Comprehensive Income — three and nine months ended September 30, 2015 and 2014</u> | 5      |
| <u>Consolidated Statements of Shareholders' Equity — nine months ended September 30, 2015 and 2014</u>           | 5      |
| <u>Consolidated Statements of Cash Flows — nine months ended September 30, 2015 and 2014</u>                     | 6      |
| <u>Notes to the Consolidated Financial Statements</u>  | 7      |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>             | 28     |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>  | 36     |
| <u>Item 4. Controls and Procedures</u>   | 36     |
| <br><u>PART II. OTHER INFORMATION</u>  |        |
| <u>Item 1. Legal Proceedings</u>   | 37     |
| <u>Item 1A. Risk Factors</u>   | 37     |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>                                       | 38     |
| <u>Item 3. Defaults Upon Senior Securities</u>   | 38     |
| <u>Item 4. Mine Safety Disclosures</u>   | 38     |
| <u>Item 5. Other Information</u>   | 38     |
| <u>Item 6. Exhibits</u>  | 38     |
| <br><u>SIGNATURES</u>  | <br>39 |
| <br><u>EXHIBITS</u>  |        |
| <u>Exhibit 31.1</u>  |        |
| <u>Exhibit 31.2</u>  |        |
| <u>Exhibit 32.1</u>  |        |
| <u>Exhibit 32.2</u>  |        |

Table of Contents

1st SOURCE CORPORATION  
 CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION  
 (Unaudited - Dollars in thousands)

|  | September 30,<br>2015 | December 31,<br>2014 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Cash and due from banks  | \$61,124              | \$64,834             |
| Federal funds sold and interest bearing deposits with other banks  | 3,065                 | 1,356                |
| Investment securities available-for-sale (amortized cost of \$769,053 and \$776,057 at September 30, 2015 and December 31, 2014, respectively) | 784,585               | 791,118              |
| Other investments  | 21,728                | 20,801               |
| Trading account securities   | —                     | 205                  |
| Mortgages held for sale  | 9,187                 | 13,604               |
| Loans and leases, net of unearned discount:  |                       |                      |
| Commercial and agricultural  | 750,780               | 710,758              |
| Auto and light truck   | 423,147               | 397,902              |
| Medium and heavy duty truck  | 264,784               | 247,153              |
| Aircraft financing   | 794,129               | 727,665              |
| Construction equipment financing   | 450,112               | 399,940              |
| Commercial real estate   | 658,589               | 616,587              |
| Residential real estate  | 463,824               | 445,759              |
| Consumer   | 150,185               | 142,810              |
| Total loans and leases   | 3,955,550             | 3,688,574            |
| Reserve for loan and lease losses  | (87,616)              | (85,068)             |
| Net loans and leases   | 3,867,934             | 3,603,506            |
| Equipment owned under operating leases, net  | 95,785                | 74,143               |
| Net premises and equipment   | 51,252                | 50,328               |
| Goodwill and intangible assets   | 84,822                | 85,371               |
| Accrued income and other assets  | 126,102               | 124,692              |
| Total assets   | \$5,105,584           | \$4,829,958          |
| <b>LIABILITIES</b>   |                       |                      |
| Deposits:  |                       |                      |
| Noninterest bearing  | \$914,152             | \$796,241            |
| Interest bearing   | 3,105,004             | 3,006,619            |
| Total deposits   | 4,019,156             | 3,802,860            |
| Short-term borrowings:   |                       |                      |
| Federal funds purchased and securities sold under agreements to repurchase   | 139,414               | 138,843              |
| Other short-term borrowings  | 144,096               | 106,979              |
| Total short-term borrowings  | 283,510               | 245,822              |
| Long-term debt and mandatorily redeemable securities   | 57,577                | 56,232               |
| Subordinated notes   | 58,764                | 58,764               |
| Accrued expenses and other liabilities   | 47,356                | 51,807               |
| Total liabilities  | 4,466,363             | 4,215,485            |
| <b>SHAREHOLDERS' EQUITY</b>  |                       |                      |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|  |             |             |
|--|-------------|-------------|
| Preferred stock; no par value  |             |             |
| Authorized 10,000,000 shares; none issued or outstanding   | —           | —           |
| Common stock; no par value   |             |             |
| Authorized 40,000,000 shares; issued 28,205,674 at September 30, 2015 and 28,206,076 at December 31, 2014*           | 436,538     | 346,535     |
| Retained earnings  | 242,102     | 302,242     |
| Cost of common stock in treasury (2,123,527 shares at September 30, 2015 and 1,957,386 shares at December 31, 2014)* | (49,120     | ) (43,711 ) |
| Accumulated other comprehensive income   | 9,701       | 9,407       |
| Total shareholders' equity   | 639,221     | 614,473     |
| Total liabilities and shareholders' equity   | \$5,105,584 | \$4,829,958 |

\*December 31, 2014 share data gives retrospective recognition to a 10% stock dividend declared on July 22, 2015 and issued on August 14, 2015.

The accompanying notes are a part of the consolidated financial statements.

Table of Contents

1st SOURCE CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited - Dollars in thousands, except per share amounts)

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2015                                | 2014     | 2015                               | 2014      |
| Interest income:  |                                     |          |                                    |           |
| Loans and leases  | \$42,560                            | \$41,118 | \$124,747                          | \$120,434 |
| Investment securities, taxable                                | 3,277                               | 2,962    | 8,929                              | 9,708     |
| Investment securities, tax-exempt                             | 738                                 | 831      | 2,261                              | 2,466     |
| Other   | 246                                 | 241      | 730                                | 750       |
| Total interest income   | 46,821                              | 45,152   | 136,667                            | 133,358   |
| Interest expense:   |                                     |          |                                    |           |
| Deposits  | 2,874                               | 2,765    | 8,271                              | 8,730     |
| Short-term borrowings   | 147                                 | 134      | 381                                | 440       |
| Subordinated notes  | 1,055                               | 1,055    | 3,165                              | 3,165     |
| Long-term debt and mandatorily redeemable securities          | 536                                 | 488      | 1,540                              | 1,533     |
| Total interest expense  | 4,612                               | 4,442    | 13,357                             | 13,868    |
| Net interest income   | 42,209                              | 40,710   | 123,310                            | 119,490   |
| Provision for loan and lease losses                           | 992                                 | 1,206    | 2,160                              | 4,553     |
| Net interest income after provision for loan and lease losses | 41,217                              | 39,504   | 121,150                            | 114,937   |
| Noninterest income:   |                                     |          |                                    |           |
| Trust fees  | 4,634                               | 4,499    | 14,438                             | 13,930    |
| Service charges on deposit accounts                           | 2,413                               | 2,225    | 6,977                              | 6,498     |
| Debit card income   | 2,583                               | 2,382    | 7,610                              | 7,077     |
| Mortgage banking income                                       | 969                                 | 1,446    | 3,459                              | 3,961     |
| Insurance commissions   | 1,460                               | 1,317    | 4,147                              | 4,168     |
| Equipment rental income                                       | 5,881                               | 4,361    | 16,302                             | 12,541    |
| Gains on investment securities available-for-sale             | —                                   | —        | 4                                  | 963       |
| Other income  | 3,192                               | 3,162    | 9,477                              | 8,873     |
| Total noninterest income                                      | 21,132                              | 19,392   | 62,414                             | 58,011    |
| Noninterest expense:  |                                     |          |                                    |           |
| Salaries and employee benefits                                | 21,835                              | 20,790   | 63,554                             | 59,099    |
| Net occupancy expense   | 2,496                               | 2,252    | 7,302                              | 6,924     |
| Furniture and equipment expense                               | 4,604                               | 4,415    | 13,471                             | 13,065    |
| Depreciation - leased equipment                               | 4,858                               | 3,571    | 13,342                             | 10,110    |
| Professional fees   | 1,237                               | 1,158    | 3,215                              | 3,348     |
| Supplies and communication                                    | 1,307                               | 1,424    | 4,122                              | 4,153     |
| FDIC and other insurance                                      | 848                                 | 856      | 2,544                              | 2,570     |
| Business development and marketing expense                    | 1,244                               | 1,218    | 3,507                              | 3,801     |
| Loan and lease collection and repossession expense            | 416                                 | 652      | 485                                | 140       |
| Other expense   | 2,223                               | 1,317    | 5,828                              | 4,839     |
| Total noninterest expense                                     | 41,068                              | 37,653   | 117,370                            | 108,049   |
| Income before income taxes                                    | 21,281                              | 21,243   | 66,194                             | 64,899    |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Income tax expense                                  | 7,353      | 6,296      | 23,125     | 21,826     |
| Net income  | \$13,928   | \$14,947   | \$43,069   | \$43,073   |
| Per common share*:                                  |            |            |            |            |
| Basic net income per common share                   | \$0.53     | \$0.56     | \$1.63     | \$1.61     |
| Diluted net income per common share                 | \$0.53     | \$0.56     | \$1.63     | \$1.61     |
| Cash dividends                                      | \$0.164    | \$0.164    | \$0.491    | \$0.482    |
| Basic weighted average common shares outstanding*   | 26,164,646 | 26,262,864 | 26,211,630 | 26,497,500 |
| Diluted weighted average common shares outstanding* | 26,164,646 | 26,262,864 | 26,211,630 | 26,497,500 |

\*The computation of per common share data and shares outstanding gives retrospective recognition to a 10% stock dividend declared on July 22, 2015 and issued on August 14, 2015.

The accompanying notes are a part of the consolidated financial statements.

Table of Contents

1st SOURCE CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited - Dollars in thousands)

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2015                                | 2014      | 2015                               | 2014      |
| Net income  | \$ 13,928                           | \$ 14,947 | \$ 43,069                          | \$ 43,073 |
| Other comprehensive income (loss):  |                                     |           |                                    |           |
| Change in unrealized appreciation (depreciation) of available-for-sale securities | 2,256                               | (2,507    | ) 475                              | 4,268     |
| Reclassification adjustment for realized (gains) losses included in net income    | —                                   | —         | (4                                 | ) (963    |
| Income tax effect   | (847                                | ) 941     | (177                               | ) (1,241  |
| Other comprehensive income (loss), net of tax                                     | 1,409                               | (1,566    | ) 294                              | 2,064     |
| Comprehensive income  | \$ 15,337                           | \$ 13,381 | \$ 43,363                          | \$ 45,137 |

The accompanying notes are a part of the consolidated financial statements.

1st SOURCE CORPORATION  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(Unaudited - Dollars in thousands, except per share amounts)

|   | Preferred<br>Stock | Common<br>Stock | Retained<br>Earnings | Cost of<br>Common<br>Stock<br>in Treasury | Accumulated<br>Other<br>Comprehensive<br>Income (Loss), Net | Total      |
|---|--------------------|-----------------|----------------------|---|---|------------|
| Balance at January 1, 2014  | \$—                | \$ 346,535      | \$ 261,626           | \$(29,364                                 | ) \$ 6,581  | \$ 585,378 |
| Net income  | —                  | —               | 43,073               | —   | —   | 43,073     |
| Other comprehensive income  | —                  | —               | —                    | —   | 2,064   | 2,064      |
| Issuance of 91,464 common shares under stock based compensation awards, including related tax effects*  | —                  | —               | (244                 | ) 1,990                                   | —   | 1,746      |
| Cost of 597,747 shares of common stock acquired for treasury*   | —                  | —               | —                    | (16,342                                   | ) —   | (16,342    |
| Common stock cash dividend (\$0.482 per share)*   | —                  | —               | (12,886              | ) —                                       | —   | (12,886    |
| Balance at September 30, 2014   | \$—                | \$ 346,535      | \$ 291,569           | \$(43,716                                 | ) \$ 8,645  | \$ 603,033 |
| Balance at January 1, 2015  | \$—                | \$ 346,535      | \$ 302,242           | \$(43,711                                 | ) \$ 9,407  | \$ 614,473 |
| Net income  | —                  | —               | 43,069               | —   | —   | 43,069     |
| Other comprehensive income  | —                  | —               | —                    | —   | 294   | 294        |
| Issuance of 117,122 common shares under stock based compensation awards, including related tax effects* | —                  | —               | (252                 | ) 2,799                                   | —   | 2,547      |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|   |     |           |           |           |   |          |           |   |
|---|-----|-----------|-----------|-----------|---|----------|-----------|---|
| Cost of 283,263 shares of common stock acquired for treasury*           | —   | —         | —         | (8,208    | ) | —        | (8,208    | ) |
| Common stock cash dividend (\$0.491 per share)*                         | —   | —         | (12,941   | )         | — | —        | (12,941   | ) |
| 10% common stock dividend (\$13 cash paid in lieu of fractional shares) | —   | 90,003    | (90,016   | )         | — | —        | (13       | ) |
| Balance at September 30, 2015   | \$— | \$436,538 | \$242,102 | \$(49,120 | ) | \$ 9,701 | \$639,221 |   |

\*Share and per share data gives retrospective recognition to a 10% stock dividend declared on July 22, 2015 and issued on August 14, 2015.

The accompanying notes are a part of the consolidated financial statements.

Table of Contents

1st SOURCE CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited - Dollars in thousands)

|   | Nine Months Ended September<br>30, |           |
|---|------------------------------------|-----------|
|   | 2015                               | 2014      |
| Operating activities:   |                                    |           |
| Net income  | \$43,069                           | \$43,073  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |           |
| Provision for loan and lease losses   | 2,160                              | 4,553     |
| Depreciation of premises and equipment  | 3,517                              | 3,502     |
| Depreciation of equipment owned and leased to others                              | 13,342                             | 10,110    |
| Stock-based compensation  | 2,953                              | 2,640     |
| Amortization of investment securities premiums and accretion of discounts, net    | 3,433                              | 3,411     |
| Amortization of mortgage servicing rights   | 1,117                              | 930       |
| Deferred income taxes   | (3,914)                            | (1,629)   |
| Gains on investment securities available-for-sale                                 | (4)                                | (963)     |
| Originations of loans held for sale, net of principal collected                   | (90,381)                           | (91,936)  |
| Proceeds from the sales of loans held for sale                                    | 97,402                             | 87,518    |
| Net gain on sale of loans held for sale   | (2,604)                            | (2,573)   |
| Net gain on sale of other real estate and repossessions                           | (818)                              | (1,510)   |
| Change in trading account securities  | 205                                | (4)       |
| Change in interest receivable   | (666)                              | (945)     |
| Change in interest payable  | 312                                | (955)     |
| Change in other assets  | (4,802)                            | (3,008)   |
| Change in other liabilities   | 5,068                              | (1,218)   |
| Other   | 1,200                              | 2,288     |
| Net change in operating activities  | 70,589                             | 53,284    |
| Investing activities:   |                                    |           |
| Proceeds from sales of investment securities                                      | 1,299                              | 1,236     |
| Proceeds from maturities of investment securities                                 | 78,033                             | 138,316   |
| Purchases of investment securities  | (75,757)                           | (119,700) |
| Net change in other investments   | (927)                              | (617)     |
| Loans sold or participated to others  | 1,962                              | 15,363    |
| Net change in loans and leases  | (276,108)                          | (127,646) |
| Net change in equipment owned under operating leases                              | (34,984)                           | (15,156)  |
| Purchases of premises and equipment   | (4,612)                            | (4,254)   |
| Proceeds from sales of other real estate and repossessions                        | 6,788                              | 9,522     |
| Net change in investing activities  | (304,306)                          | (102,936) |
| Financing activities:   |                                    |           |
| Net change in demand deposits and savings accounts                                | 140,737                            | 52,369    |
| Net change in time deposits   | 75,559                             | 129,953   |
| Net change in short-term borrowings   | 37,688                             | (97,409)  |
| Proceeds from issuance of long-term debt  | —                                  | 7,185     |
| Payments on long-term debt  | (924)                              | (11,433)  |
| Stock issued under stock purchase plans   | 149                                | 197       |
| Acquisition of treasury stock   | (8,208)                            | (16,342)  |
| Cash dividends paid on common stock   | (13,285)                           | (13,209)  |
| Net change in financing activities  | 231,716                            | 51,311    |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|  |          |          |
|--|----------|----------|
| Net change in cash and cash equivalents  | (2,001   | ) 1,659  |
| Cash and cash equivalents, beginning of year   | 66,190   | 80,052   |
| Cash and cash equivalents, end of period   | \$64,189 | \$81,711 |
| Supplemental Information:  |          |          |
| Non-cash transactions:   |          |          |
| Loans transferred to other real estate and repossessed assets                          | \$7,558  | \$6,528  |
| Common stock matching contribution to Employee Stock Ownership and Profit Sharing Plan | 500      | —        |

The accompanying notes are a part of the consolidated financial statements.

6

---

Table of Contents

1ST SOURCE CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Accounting Policies

1st Source Corporation is a bank holding company headquartered in South Bend, Indiana that provides, through its subsidiaries (collectively referred to as “1st Source” or “the Company”), a broad array of financial products and services.

**Basis of Presentation** – The accompanying unaudited consolidated financial statements reflect all adjustments (all of which are normal and recurring in nature) which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, the results of operations, changes in comprehensive income, changes in shareholders’ equity, and cash flows for the periods presented. These unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been omitted.

The Notes to the Consolidated Financial Statements appearing in 1st Source Corporation’s Annual Report on Form 10-K (2014 Annual Report), which include descriptions of significant accounting policies, should be read in conjunction with these interim financial statements. The Consolidated Statement of Financial Condition at December 31, 2014 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. Certain amounts in the prior period consolidated financial statements have been reclassified to conform to the current year presentation.

**Use of Estimates in the Preparation of Financial Statements** – Financial statements prepared in accordance with GAAP require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expense during the reporting period. Actual results could differ from those estimates.

**Loans and Leases** – Loans are stated at the principal amount outstanding, net of unamortized deferred loan origination fees and costs and net of unearned income. Interest income is accrued as earned based on unpaid principal balances. Origination fees and direct loan and lease origination costs are deferred and the net amount amortized to interest income over the estimated life of the related loan or lease. Loan commitment fees are deferred and amortized into other income over the commitment period.

Direct financing leases are carried at the aggregate of lease payments plus estimated residual value of the leased property, net of unamortized deferred lease origination fees and costs and unearned income. Interest income on direct financing leases is recognized over the term of the lease to achieve a constant periodic rate of return on the outstanding investment.

The accrual of interest on loans and leases is discontinued when a loan or lease becomes contractually delinquent for 90 days, or when an individual analysis of a borrower’s credit worthiness indicates a credit should be placed on nonperforming status, except for residential mortgage loans and consumer loans that are well secured and in the process of collection. Residential mortgage loans are placed on nonaccrual at the time the loan is placed in foreclosure. When interest accruals are discontinued, interest credited to income in the current year is reversed and interest accrued in the prior year is charged to the reserve for loan and lease losses. However, in some cases, the Company may elect to continue the accrual of interest when the net realizable value of collateral is sufficient to cover the principal and accrued interest. When a loan or lease is classified as nonaccrual and the future collectibility of the recorded loan or lease balance is doubtful, collections on interest and principal are applied as a reduction to principal outstanding. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured, which is typically evidenced by a sustained repayment performance of at least six months.

A loan or lease is considered impaired, based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan or lease agreement. Interest on impaired loans and leases, which are not classified as nonaccrual, is recognized on the accrual basis. The Company evaluates loans and leases exceeding \$100,000 for impairment and establishes a specific reserve as a component of the reserve for loan and lease losses when it is probable all amounts

due will not be collected pursuant to the contractual terms of the loan or lease and the recorded investment in the loan or lease exceeds its fair value.

Loans and leases that have been modified and economic concessions have been granted to borrowers who have experienced financial difficulties are considered a troubled debt restructuring (TDR) and, by definition, are deemed an impaired loan. These concessions typically result from the Company's loss mitigation activities and may include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower's sustained repayment performance for a reasonable period of at least six months.

7

---

Table of Contents

When the Company modifies loans and leases in a TDR, it evaluates any possible impairment similar to other impaired loans based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan or lease agreement, or uses the current fair value of the collateral, less selling costs for collateral dependent loans. If the Company determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through a reserve for loan and lease losses estimate or a charge-off to the reserve for loan and lease losses. In periods subsequent to modification, the Company evaluates all TDRs, including those that have payment defaults, for possible impairment and recognizes impairment through the reserve for loan and lease losses.

Note 2. Recent Accounting Pronouncements

**Short Duration Contracts:** In May 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-09 “Financial Services - Insurance (Topic 944) - Disclosures about Short Duration Contracts.” ASU 2015-09 includes amendments that require insurance entities to disclose for annual reporting periods information about the liability for unpaid claims and claim adjustment expenses as well as significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses. In addition, the amendments require a roll-forward of the liability for unpaid claims and claim adjustment expenses on an annual and interim basis. The amendments are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016 and should be applied retrospectively. Early adoption is permitted. The Company is assessing the impact of ASU 2015-09 on its disclosures.

**Consolidations:** In February 2015, the FASB issued ASU No. 2015-02 “Consolidation (Topic 810) - Amendments to the Consolidation Analysis.” ASU 2015-02 includes amendments that are intended to improve targeted areas of consolidation for legal entities including reducing the number of consolidation models from four to two and simplifying the FASB Accounting Standards Codification. ASU 2015-02 is effective for annual and interim periods within those annual periods, beginning after December 15, 2015. The amendments may be applied retrospectively in previously issued financial statements for one or more years with a cumulative effect adjustment to retained earnings as of the beginning of the first year restated. Early adoption is permitted, including adoption in an interim period. The Company is assessing the impact of ASU 2015-02 on its accounting and disclosures.

**Troubled Debt Restructurings by Creditors:** In August 2014, the FASB issued ASU No. 2014-14 “Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Classification of Certain Government Guaranteed Mortgage Loans upon Foreclosure.” ASU 2014-14 requires that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if certain conditions are met. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. ASU 2014-14 is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2014. The amendments can be applied using either a prospective transition method or a modified retrospective transition method. Early adoption is permitted. The Company adopted ASU 2014-14 on January 1, 2015 and it did not have an impact on its accounting and disclosures.

**Share Based Payments:** In June 2014, the FASB issued ASU No. 2014-12 “Compensation - Stock Compensation (Topic 718) - Accounting for Share Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period.” ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. ASU 2014-12 is effective for interim and annual periods beginning after December 15, 2015. The amendments can be applied prospectively to all awards granted or modified after the effective date or retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented and to all new or modified awards thereafter. Early adoption is permitted. The Company has determined that ASU 2014-12 will not have an impact on its accounting and disclosures.

**Repurchase to Maturity Transactions, Repurchase Financings and Disclosures:** In June 2014, the FASB issued ASU No. 2014-11 “Transfers and Servicing (Topic 860) - Repurchase to Maturity Transactions, Repurchase Financings, and Disclosures.” ASU 2014-11 aligns the accounting for repurchase to maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. ASU 2014-11 is effective for the first interim or annual

period beginning after December 15, 2014. In addition the disclosure of certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is prohibited. The Company adopted ASU 2014-11 on January 1, 2015 and it did not have a material impact on its accounting and disclosures.

Table of Contents

Revenue from Contracts with Customers: In May 2014, the FASB issued ASU No. 2014-09 “Revenue from Contracts with Customers (Topic 606).” The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. Early application is permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. The Company is assessing the impact of ASU 2014-09 on its accounting and disclosures.

Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure: In January 2014, the FASB issued ASU No. 2014-04 “Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure.” ASU 2014-04 clarifies when an in substance repossession or foreclosure occurs and requires interim and annual disclosures of the amount of foreclosed residential real estate property and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. ASU 2014-04 is effective either on a modified retrospective transition method or a prospective transition method for interim and annual periods beginning after December 15, 2014. Early adoption is permitted. The Company adopted ASU 2014-04 on January 1, 2015 and it did not have a material impact on its disclosures.

Accounting for Investments in Qualified Affordable Housing Projects: In January 2014, the FASB issued ASU No. 2014-01 “Investments - Equity method and Joint Ventures (Topic 323) - Accounting for Investments in Qualified Affordable Housing Projects.” ASU 2014-01 allows investors to use the proportional amortization method to account for investments in limited liability entities that manage or invest in affordable housing projects that qualify for low-income housing tax credits if certain conditions are met. ASU 2014-01 is effective retrospectively for interim and annual periods in fiscal years that begin after December 15, 2014. Early adoption is permitted. The Company adopted ASU 2014-01 on January 1, 2015 and it did not have a material impact on its accounting and disclosures for affordable housing projects.

### Note 3. Investment Securities

The following table shows investment securities available-for-sale.

| (Dollars in thousands)                            | Amortized Cost | Gross<br>Unrealized Gains | Gross<br>Unrealized Losses | Fair Value  |
|---|----------------|---------------------------|----------------------------|-------------|
| September 30, 2015                                |                |                           |                            |             |
| U.S. Treasury and Federal agencies securities     | \$380,723      | \$ 3,570                  | \$ (217)                   | ) \$384,076 |
| U.S. States and political subdivisions securities | 118,770        | 2,944                     | (122)                      | ) 121,592   |
| Mortgage-backed securities — Federal agencies     | 232,568        | 4,681                     | (841)                      | ) 236,408   |
| Corporate debt securities                         | 34,299         | 324                       | (14)                       | ) 34,609    |
| Foreign government and other securities           | 800            | 11                        | —                          | ) 811       |
| Total debt securities                             | 767,160        | 11,530                    | (1,194)                    | ) 777,496   |
| Marketable equity securities                      | 1,893          | 5,357                     | (161)                      | ) 7,089     |
| Total investment securities available-for-sale    | \$769,053      | \$ 16,887                 | \$ (1,355)                 | ) \$784,585 |
| December 31, 2014                                 |                |                           |                            |             |
| U.S. Treasury and Federal agencies securities     | \$371,878      | \$ 3,593                  | \$ (1,968)                 | ) \$373,503 |
| U.S. States and political subdivisions securities | 121,510        | 3,392                     | (214)                      | ) 124,688   |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|  |           |           |           |             |
|--|-----------|-----------|-----------|-------------|
| Mortgage-backed securities — Federal agencies  | 248,299   | 5,490     | (781      | ) 253,008   |
| Corporate debt securities                      | 31,677    | 281       | (26       | ) 31,932    |
| Foreign government and other securities        | 800       | 11        | —         | 811         |
| Total debt securities                          | 774,164   | 12,767    | (2,989    | ) 783,942   |
| Marketable equity securities                   | 1,893     | 5,285     | (2        | ) 7,176     |
| Total investment securities available-for-sale | \$776,057 | \$ 18,052 | \$ (2,991 | ) \$791,118 |

At September 30, 2015 and December 31, 2014, the residential mortgage-backed securities held by the Company consisted primarily of GNMA, FNMA and FHLMC pass-through certificates which are guaranteed by those respective agencies of the United States government (Government Sponsored Enterprise, GSEs).

Table of Contents

The following table shows the contractual maturities of investments in securities available-for-sale at September 30, 2015. Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (Dollars in thousands)                   | Amortized Cost | Fair Value |
|--|----------------|------------|
| Due in one year or less                  | \$107,463      | \$108,140  |
| Due after one year through five years    | 409,967        | 415,432    |
| Due after five years through ten years   | 17,162         | 17,516     |
| Due after ten years                      | —              | —          |
| Mortgage-backed securities               | 232,568        | 236,408    |
| Total debt securities available-for-sale | \$767,160      | \$777,496  |

The following table shows the gross realized gains and losses on sale of securities from the securities available-for-sale portfolio, including marketable equity securities. Realized gains and losses on the sales of all securities are computed using the specific identification cost basis. The gross gains for the nine months ended September 30, 2014 reflect the sale of marketable equity securities.

| (Dollars in thousands)      | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |       |
|-----------------------------|-------------------------------------|------|------------------------------------|-------|
|                             | 2015                                | 2014 | 2015                               | 2014  |
| Gross realized gains        | \$—                                 | \$—  | \$4                                | \$963 |
| Gross realized losses       | —                                   | —    | —                                  | —     |
| Net realized gains (losses) | \$—                                 | \$—  | \$4                                | \$963 |

The following table summarizes gross unrealized losses and fair value by investment category and age.

| (Dollars in thousands)                            | Less than 12 Months |                      | 12 months or Longer |                      | Total      |                      |
|---|---------------------|----------------------|---------------------|----------------------|------------|----------------------|
|   | Fair Value          | Unrealized<br>Losses | Fair Value          | Unrealized<br>Losses | Fair Value | Unrealized<br>Losses |
| September 30, 2015                                |                     |                      |                     |                      |            |                      |
| U.S. Treasury and Federal agencies securities     | \$16,881            | \$(8 )               | \$74,746            | \$(209 )             | \$91,627   | \$(217 )             |
| U.S. States and political subdivisions securities | 13,288              | (91 )                | 2,325               | (31 )                | 15,613     | (122 )               |
| Mortgage-backed securities - Federal agencies     | 31,223              | (226 )               | 19,088              | (615 )               | 50,311     | (841 )               |
| Corporate debt securities                         | 1,741               | (14 )                | —                   | —                    | 1,741      | (14 )                |
| Foreign government and other securities           | 100                 | —                    | —                   | —                    | 100        | —                    |
| Total debt securities                             | 63,233              | (339 )               | 96,159              | (855 )               | 159,392    | (1,194 )             |
| Marketable equity securities                      | 487                 | (159 )               | 3                   | (2 )                 | 490        | (161 )               |
| Total investment securities available-for-sale    | \$63,720            | \$(498 )             | \$96,162            | \$(857 )             | \$159,882  | \$(1,355 )           |
| December 31, 2014                                 |                     |                      |                     |                      |            |                      |
| U.S. Treasury and Federal agencies securities     | \$54,944            | \$(148 )             | \$115,195           | \$(1,820 )           | \$170,139  | \$(1,968 )           |
| U.S. States and political subdivisions securities | 16,805              | (112 )               | 8,333               | (102 )               | 25,138     | (214 )               |
| Mortgage-backed securities - Federal agencies     | 21,754              | (62 )                | 32,781              | (719 )               | 54,535     | (781 )               |
| Corporate debt securities                         | 3,072               | (26 )                | —                   | —                    | 3,072      | (26 )                |
| Foreign government and other securities           | —                   | —                    | —                   | —                    | —          | —                    |
| Total debt securities                             | 96,575              | (348 )               | 156,309             | (2,641 )             | 252,884    | (2,989 )             |
| Marketable equity securities                      | —                   | —                    | 3                   | (2 )                 | 3          | (2 )                 |
| Total investment securities available-for-sale    | \$96,575            | \$(348 )             | \$156,312           | \$(2,643 )           | \$252,887  | \$(2,991 )           |

The initial indication of other-than-temporary-impairment (OTTI) for both debt and equity securities is a decline in fair value below amortized cost. Quarterly, the impaired securities are analyzed on a qualitative and quantitative basis in determining OTTI. Declines in the fair value of available-for-sale debt securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of impairment related to other factors is recognized in other comprehensive income. In estimating OTTI impairment losses, the Company considers among other things, (i) the length of time and the extent to which fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) whether it is more likely than not that the Company will not have to sell any such securities before a recovery of cost.

Table of Contents

There were no OTTI write-downs in 2015 or 2014.

At September 30, 2015, the Company does not have the intent to sell any of the available-for-sale securities in the table above and believes that it is more likely than not, that it will not have to sell any such securities before an anticipated recovery of cost. Primarily the unrealized losses on debt securities are due to increases in market rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover on all debt securities as they approach their maturity date or re-pricing date or if market yields for such investments decline. The Company does not believe any of the securities are impaired due to reasons of credit quality.

At September 30, 2015 and December 31, 2014, investment securities with carrying values of \$218.75 million and \$231.50 million, respectively, were pledged as collateral for security repurchase agreements and for other purposes.

#### Note 4. Loan and Lease Financings

The Company evaluates loans and leases for credit quality at least annually but more frequently if certain circumstances occur (such as material new information which becomes available and indicates a potential change in credit risk). The Company uses two methods to assess credit risk: loan or lease credit quality grades and credit risk classifications. The purpose of the loan or lease credit quality grade is to document the degree of risk associated with individual credits as well as inform management of the degree of risk in the portfolio taken as a whole. Credit risk classifications are used to categorize loans by degree of risk and to designate individual or committee approval authorities for higher risk credits at the time of origination. Credit risk classifications include categories for: Acceptable, Marginal, Special Attention, Special Risk, Restricted by Policy, Regulated and Prohibited by Law. All loans and leases, except residential real estate loans and consumer loans, are assigned credit quality grades on a scale from 1 to 12 with grade 1 representing superior credit quality. The criteria used to assign grades to extensions of credit that exhibit potential problems or well-defined weaknesses are primarily based upon the degree of risk and the likelihood of orderly repayment, and their effect on the Company's safety and soundness. Loans or leases graded 7 or weaker are considered "special attention" credits and, as such, relationships in excess of \$100,000 are reviewed quarterly as part of management's evaluation of the appropriateness of the reserve for loan and lease losses. Grade 7 credits are defined as "watch" and contain greater than average credit risk and are monitored to limit the exposure to increased risk; grade 8 credits are "special mention" and, following regulatory guidelines, are defined as having potential weaknesses that deserve management's close attention. Credits that exhibit well-defined weaknesses and a distinct possibility of loss are considered "classified" and are graded 9 through 12 corresponding to the regulatory definitions of "substandard" (grades 9 and 10) and the more severe "doubtful" (grade 11) and "loss" (grade 12). The following table shows the credit quality grades of the recorded investment in loans and leases, segregated by class.

| (Dollars in thousands)           | Credit Quality Grades |          |             |
|----------------------------------|-----------------------|----------|-------------|
|                                  | 1-6                   | 7-12     | Total       |
| September 30, 2015               |                       |          |             |
| Commercial and agricultural      | \$735,249             | \$15,531 | \$750,780   |
| Auto and light truck             | 412,083               | 11,064   | 423,147     |
| Medium and heavy duty truck      | 261,691               | 3,093    | 264,784     |
| Aircraft financing               | 765,908               | 28,221   | 794,129     |
| Construction equipment financing | 442,876               | 7,236    | 450,112     |
| Commercial real estate           | 640,751               | 17,838   | 658,589     |
| Total                            | \$3,258,558           | \$82,983 | \$3,341,541 |
| December 31, 2014                |                       |          |             |
| Commercial and agricultural      | \$683,169             | \$27,589 | \$710,758   |
| Auto and light truck             | 380,425               | 17,477   | 397,902     |
| Medium and heavy duty truck      | 243,798               | 3,355    | 247,153     |
| Aircraft financing               | 691,018               | 36,647   | 727,665     |
| Construction equipment financing | 393,965               | 5,975    | 399,940     |
| Commercial real estate           | 592,787               | 23,800   | 616,587     |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|       |             |           |             |
|-------|-------------|-----------|-------------|
| Total | \$2,985,162 | \$114,843 | \$3,100,005 |
|-------|-------------|-----------|-------------|

11

---

Table of Contents

For residential real estate and consumer loans, credit quality is based on the aging status of the loan and by payment activity. The following table shows the recorded investment in residential real estate and consumer loans by performing or nonperforming status. Nonperforming loans are those loans which are on nonaccrual status or are 90 days or more past due.

| (Dollars in thousands)  | Performing | Nonperforming | Total     |
|-------------------------|------------|---------------|-----------|
| September 30, 2015      |            |               |           |
| Residential real estate | \$461,156  | \$2,668       | \$463,824 |
| Consumer                | 149,845    | 340           | 150,185   |
| Total                   | \$611,001  | \$3,008       | \$614,009 |
| December 31, 2014       |            |               |           |
| Residential real estate | \$442,918  | \$2,841       | \$445,759 |
| Consumer                | 142,476    | 334           | 142,810   |
| Total                   | \$585,394  | \$3,175       | \$588,569 |

The following table shows the recorded investment of loans and leases, segregated by class, with delinquency aging and nonaccrual status.

| (Dollars in thousands)           | Current     | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | 90 Days or<br>More Past<br>Due<br>and Accruing | Total<br>Accruing<br>Loans | Nonaccrual | Total<br>Financing<br>Receivables |
|----------------------------------|-------------|---------------------------|---------------------------|--|----------------------------|------------|-----------------------------------|
| September 30, 2015               |             |                           |                           |  |                            |            |                                   |
| Commercial and agricultural      | \$743,570   | \$67                      | \$—                       | \$—  | \$743,637                  | \$7,143    | \$750,780                         |
| Auto and light truck             | 422,943     | 141                       | 12                        | —  | 423,096                    | 51         | 423,147                           |
| Medium and heavy duty truck      | 264,784     | —                         | —                         | —  | 264,784                    | —          | 264,784                           |
| Aircraft financing               | 772,554     | 6,718                     | 7,681                     | —  | 786,953                    | 7,176      | 794,129                           |
| Construction equipment financing | 448,996     | 461                       | —                         | —  | 449,457                    | 655        | 450,112                           |
| Commercial real estate           | 657,102     | 124                       | —                         | —  | 657,226                    | 1,363      | 658,589                           |
| Residential real estate          | 459,657     | 1,049                     | 450                       | 341  | 461,497                    | 2,327      | 463,824                           |
| Consumer                         | 148,876     | 834                       | 135                       | 70   | 149,915                    | 270        | 150,185                           |
| Total                            | \$3,918,482 | \$9,394                   | \$8,278                   | \$411  | \$3,936,565                | \$18,985   | \$3,955,550                       |
| December 31, 2014                |             |                           |                           |  |                            |            |                                   |
| Commercial and agricultural      | \$696,351   | \$—                       | \$123                     | \$—  | \$696,474                  | \$14,284   | \$710,758                         |
| Auto and light truck             | 397,815     | 48                        | 1                         | —  | 397,864                    | 38         | 397,902                           |
| Medium and heavy duty truck      | 247,097     | —                         | —                         | —  | 247,097                    | 56         | 247,153                           |
| Aircraft financing               | 699,054     | 541                       | 15,597                    | —  | 715,192                    | 12,473     | 727,665                           |
| Construction equipment financing | 396,821     | 999                       | 1,369                     | —  | 399,189                    | 751        | 399,940                           |
| Commercial real estate           | 611,780     | —                         | —                         | —  | 611,780                    | 4,807      | 616,587                           |
| Residential real estate          | 441,508     | 1,099                     | 311                       | 873  | 443,791                    | 1,968      | 445,759                           |
| Consumer                         | 141,577     | 676                       | 223                       | 109  | 142,585                    | 225        | 142,810                           |
| Total                            | \$3,632,003 | \$3,363                   | \$17,624                  | \$982  | \$3,653,972                | \$34,602   | \$3,688,574                       |



Table of Contents

The following table shows impaired loans and leases, segregated by class, and the corresponding reserve for impaired loan and lease losses.

| (Dollars in thousands)                 | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related Reserve |
|--|------------------------|--------------------------------|-----------------|
| September 30, 2015                     |                        |                                |                 |
| With no related reserve recorded:      |                        |                                |                 |
| Commercial and agricultural            | \$752                  | \$752                          | \$—             |
| Auto and light truck                   | —                      | —                              | —               |
| Medium and heavy duty truck            | —                      | —                              | —               |
| Aircraft financing                     | 4,687                  | 4,687                          | —               |
| Construction equipment financing       | 655                    | 655                            | —               |
| Commercial real estate                 | 8,264                  | 8,264                          | —               |
| Residential real estate                | —                      | —                              | —               |
| Consumer                               | —                      | —                              | —               |
| Total with no related reserve recorded | 14,358                 | 14,358                         | —               |
| With a reserve recorded:               |                        |                                |                 |
| Commercial and agricultural            | 5,919                  | 5,919                          | 2,710           |
| Auto and light truck                   | —                      | —                              | —               |
| Medium and heavy duty truck            | —                      | —                              | —               |
| Aircraft financing                     | 2,460                  | 2,460                          | 617             |
| Construction equipment financing       | —                      | —                              | —               |
| Commercial real estate                 | 751                    | 751                            | 22              |
| Residential real estate                | 368                    | 370                            | 150             |
| Consumer                               | —                      | —                              | —               |
| Total with a reserve recorded          | 9,498                  | 9,500                          | 3,499           |
| Total impaired loans                   | \$23,856               | \$23,858                       | \$3,499         |
| December 31, 2014                      |                        |                                |                 |
| With no related reserve recorded:      |                        |                                |                 |
| Commercial and agricultural            | \$14,468               | \$14,467                       | \$—             |
| Auto and light truck                   | —                      | —                              | —               |
| Medium and heavy duty truck            | —                      | —                              | —               |
| Aircraft financing                     | 12,740                 | 12,741                         | —               |
| Construction equipment financing       | 746                    | 746                            | —               |
| Commercial real estate                 | 11,707                 | 11,707                         | —               |
| Residential real estate                | —                      | —                              | —               |
| Consumer                               | —                      | —                              | —               |
| Total with no related reserve recorded | 39,661                 | 39,661                         | —               |
| With a reserve recorded:               |                        |                                |                 |
| Commercial and agricultural            | 74                     | 74                             | 5               |
| Auto and light truck                   | —                      | —                              | —               |
| Medium and heavy duty truck            | —                      | —                              | —               |
| Aircraft financing                     | —                      | —                              | —               |
| Construction equipment financing       | —                      | —                              | —               |
| Commercial real estate                 | 798                    | 798                            | 80              |
| Residential real estate                | 373                    | 376                            | 156             |
| Consumer                               | —                      | —                              | —               |
| Total with a reserve recorded          | 1,245                  | 1,248                          | 241             |

|                      |          |          |       |
|----------------------|----------|----------|-------|
| Total impaired loans | \$40,906 | \$40,909 | \$241 |
|----------------------|----------|----------|-------|

13

---

Table of Contents

The following table shows average recorded investment and interest income recognized on impaired loans and leases, segregated by class.

| (Dollars in thousands)           | Three Months Ended September 30, |                 |                             |                 | Nine Months Ended September 30, |                 |                             |                 |
|----------------------------------|----------------------------------|-----------------|-----------------------------|-----------------|---------------------------------|-----------------|-----------------------------|-----------------|
|                                  | 2015                             |                 | 2014                        |                 | 2015                            |                 | 2014                        |                 |
|                                  | Average Recorded Investment      | Interest Income | Average Recorded Investment | Interest Income | Average Recorded Investment     | Interest Income | Average Recorded Investment | Interest Income |
| Commercial and agricultural      | \$3,882                          | \$11            | \$22,095                    | \$9             | \$5,275                         | \$27            | \$16,203                    | \$34            |
| Auto and light truck             | —                                | —               | —                           | —               | —                               | —               | 542                         | —               |
| Medium and heavy duty truck      | —                                | —               | —                           | —               | —                               | —               | —                           | —               |
| Aircraft financing               | 7,422                            | 1               | 1,157                       | 3               | 7,945                           | 6               | 3,212                       | 16              |
| Construction equipment financing | 738                              | —               | 941                         | —               | 736                             | —               | 1,001                       | —               |
| Commercial real estate           | 9,762                            | 108             | 13,415                      | 148             | 10,800                          | 392             | 13,263                      | 442             |
| Residential real estate          | 369                              | 4               | 375                         | 4               | 371                             | 12              | 377                         | 12              |
| Consumer                         | —                                | —               | —                           | —               | —                               | —               | —                           | —               |
| Total                            | \$22,173                         | \$124           | \$37,983                    | \$164           | \$25,127                        | \$437           | \$34,598                    | \$504           |

The following table shows the number of loans and leases classified as troubled debt restructuring (TDR) during the three and nine months ended September 30, 2015 and 2014, segregated by class, as well as the recorded investment as of September 30. The classification between nonperforming and performing is shown at the time of modification. Modification programs focus on extending maturity dates or modifying payment patterns with most TDRs experiencing a combination of concessions. The modifications did not result in the contractual forgiveness of principal or interest. There were no modifications during 2015 and three modifications during 2014 that resulted in an interest rate reduction below market rate. Consequently, the financial impact of the modifications was immaterial.

| (Dollars in thousands)             | Three Months Ended September 30, |                     |                         |                     | Nine Months Ended September 30, |                     |                         |                     |
|------------------------------------|----------------------------------|---------------------|-------------------------|---------------------|---------------------------------|---------------------|-------------------------|---------------------|
|                                    | 2015                             |                     | 2014                    |                     | 2015                            |                     | 2014                    |                     |
|                                    | Number of Modifications          | Recorded Investment | Number of Modifications | Recorded Investment | Number of Modifications         | Recorded Investment | Number of Modifications | Recorded Investment |
| <b>Performing TDRs:</b>            |                                  |                     |                         |                     |                                 |                     |                         |                     |
| Commercial and agricultural        | 2                                | \$ 239              | 2                       | \$ 346              | 2                               | \$ 239              | 2                       | \$ 346              |
| Auto and light truck               | —                                | —                   | —                       | —                   | —                               | —                   | —                       | —                   |
| Medium and heavy duty truck        | —                                | —                   | —                       | —                   | —                               | —                   | —                       | —                   |
| Aircraft financing                 | —                                | —                   | 1                       | 337                 | —                               | —                   | 2                       | 337                 |
| Construction equipment financing   | —                                | —                   | —                       | —                   | —                               | —                   | —                       | —                   |
| Commercial real estate             | —                                | —                   | —                       | —                   | —                               | —                   | —                       | —                   |
| Residential real estate            | —                                | —                   | —                       | —                   | —                               | —                   | —                       | —                   |
| Consumer                           | —                                | —                   | —                       | —                   | —                               | —                   | —                       | —                   |
| Total performing TDR modifications | 2                                | \$ 239              | 3                       | \$ 683              | 2                               | \$ 239              | 4                       | \$ 683              |
| <b>Nonperforming TDRs:</b>         |                                  |                     |                         |                     |                                 |                     |                         |                     |
| Commercial and agricultural        | —                                | \$ —                | 4                       | \$ 9,556            | —                               | \$ —                | 4                       | \$ 9,556            |
| Auto and light truck               | —                                | —                   | —                       | —                   | —                               | —                   | —                       | —                   |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|  |   |        |   |           |   |        |   |           |
|--|---|--------|---|-----------|---|--------|---|-----------|
| Medium and heavy<br>duty truck           | — | —      | — | —         | — | —      | — | —         |
| Aircraft financing                       | — | —      | — | —         | — | —      | — | —         |
| Construction<br>equipment financing      | — | —      | — | —         | — | —      | — | —         |
| Commercial real estate                   | — | —      | 1 | 820       | — | —      | 1 | 820       |
| Residential real estate                  | — | —      | — | —         | — | —      | — | —         |
| Consumer                                 | — | —      | — | —         | — | —      | — | —         |
| Total nonperforming<br>TDR modifications | — | \$ —   | 5 | \$ 10,376 | — | \$ —   | 5 | \$ 10,376 |
| Total TDR<br>modifications               | 2 | \$ 239 | 8 | \$ 11,059 | 2 | \$ 239 | 9 | \$ 11,059 |

Table of Contents

There were no TDRs which had payment defaults within the twelve months following modification during the three and nine months ended September 30, 2015 and 2014. Default occurs when a loan or lease is 90 days or more past due under the modified terms or transferred to nonaccrual.

The following table shows the recorded investment of loans and leases classified as troubled debt restructurings as of September 30, 2015 and December 31, 2014.

| (Dollars in thousands) | September 30,<br>2015 | December 31,<br>2014 |
|------------------------|-----------------------|----------------------|
| Performing TDRs        | \$8,483               | \$9,118              |
| Nonperforming TDRs     | 2,225                 | 14,507               |
| Total TDRs             | \$10,708              | \$23,625             |

#### Note 5. Reserve for Loan and Lease Losses

The reserve for loan and lease loss methodology has been consistently applied for several years, with enhancements instituted periodically. Reserve ratios are reviewed quarterly and revised periodically to reflect recent loss history and to incorporate current risks and trends which may not be recognized in historical data. As the historical charge-off analysis is updated, the Company reviews the look-back periods for each business loan portfolio. Furthermore, a thorough analysis of charge-offs, non-performing asset levels, special attention outstandings and delinquency is performed in order to review portfolio trends and other factors, including specific industry risks and economic conditions, which may have an impact on the reserves and reserve ratios applied to various portfolios. The Company adjusts the calculated historical based ratio as a result of the analysis of environmental factors, principally economic risk and concentration risk. Key economic factors affecting the portfolios are growth in gross domestic product, unemployment rates, housing market trends, commodity prices, inflation and global economic and political issues. Concentration risk is impacted primarily by geographic concentration in Northern Indiana and Southwestern Lower Michigan in the business banking and commercial real estate portfolios and by collateral concentration in the specialty finance portfolios and exposure to foreign markets by geographic risk.

The reserve for loan and lease losses is maintained at a level believed to be appropriate by the Company to absorb probable losses inherent in the loan and lease portfolio. The determination of the reserve requires significant judgment reflecting the Company's best estimate of probable loan and lease losses related to specifically identified impaired loans and leases as well as probable losses in the remainder of the various loan and lease portfolios. For purposes of determining the reserve, the Company has segmented loans and leases into classes based on the associated risk within these segments. The Company has determined that eight classes exist within the loan and lease portfolio. The methodology for assessing the appropriateness of the reserve consists of several key elements, which include: specific reserves for impaired loans, formula reserves for each business lending division portfolio including percentage allocations for special attention loans and leases not deemed impaired, and reserves for pooled homogeneous loans and leases. The Company's evaluation is based upon a continuing review of these portfolios, estimates of customer performance, collateral values and dispositions, and assessments of economic and geopolitical events, all of which are subject to judgment and will change.

The following table shows the changes in the reserve for loan and lease losses, segregated by class, for the three months ended September 30, 2015 and 2014.

| (Dollars in thousands)            | Commercial and agricultural | Auto and light truck | Medium and heavy duty | Aircraft financing | Construction equipment financing | Commercial real estate | Residential real estate | Consumer | Total     |
|-----------------------------------|-----------------------------|----------------------|-----------------------|--------------------|----------------------------------|------------------------|-------------------------|----------|-----------|
| September 30, 2015                |                             |                      |                       |                    |                                  |                        |                         |          |           |
| Reserve for loan and lease losses |                             |                      |                       |                    |                                  |                        |                         |          |           |
| Balance, beginning of period      | \$ 11,865                   | \$ 11,445            | \$ 4,333              | \$ 32,840          | \$ 7,807                         | \$ 13,226              | \$ 3,444                | \$ 1,628 | \$ 86,588 |
| Charge-offs                       | 88                          | —                    | —                     | 195                | —                                | —                      | 39                      | 310      | 632       |
| Recoveries                        | 80                          | 64                   | 10                    | 279                | 112                              | 39                     | 2                       | 82       | 668       |

Edgar Filing: 1ST SOURCE CORP - Form 10-Q

|                                   |           |          |          |           |          |           |          |          |           |
|-----------------------------------|-----------|----------|----------|-----------|----------|-----------|----------|----------|-----------|
| Net charge-offs (recoveries)      | 8         | (64 )    | (10 )    | (84 )     | (112 )   | (39 )     | 37       | 228      | (36 )     |
| Provision (recovery of provision) | 2,182     | (2,131 ) | 101      | 1,117     | (276 )   | (244 )    | (8 )     | 251      | 992       |
| Balance, end of period            | \$ 14,039 | \$ 9,378 | \$ 4,444 | \$ 34,041 | \$ 7,643 | \$ 13,021 | \$ 3,399 | \$ 1,651 | \$ 87,616 |

September 30, 2014

Reserve for loan and lease losses

|                                   |           |           |          |           |          |           |          |          |           |
|-----------------------------------|-----------|-----------|----------|-----------|----------|-----------|----------|----------|-----------|
| Balance, beginning of period      | \$ 16,766 | \$ 10,427 | \$ 4,281 | \$ 33,087 | \$ 6,318 | \$ 12,353 | \$ 3,934 | \$ 1,610 | \$ 88,776 |
| Charge-offs                       | 3,000     | 10        | —        | —         | 2        | 16        | 3        | 193      | 3,224     |
| Recoveries                        | 177       | 64        | 1        | 49        | 130      | 130       | 23       | 68       | 642       |
| Net charge-offs (recoveries)      | 2,823     | (54 )     | (1 )     | (49 )     | (128 )   | (114 )    | (20 )    | 125      | 2,582     |
| Provision (recovery of provision) | 1,295     | 516       | 173      | (1,672 )  | 11       | 485       | 58       | 340      | 1,206     |
| Balance, end of period            | \$ 15,238 | \$ 10,997 | \$ 4,455 | \$ 31,464 | \$ 6,457 | \$ 12,952 | \$ 4,012 | \$ 1,825 | \$ 87,400 |

Table of Contents

The following table shows the changes in the reserve for loan and lease losses, segregated by class, for the nine months ended September 30, 2015 and 2014.

| (Dollars in thousands)            | Commercial<br>agricultural | Auto and<br>light truck | Medium and<br>heavy duty | Aircraft<br>financing | Construction<br>equipment<br>financing | Commercial<br>real estate | Residential<br>real estate | Consumer<br>loans | Total     |
|-----------------------------------|----------------------------|-------------------------|--------------------------|-----------------------|--|---------------------------|----------------------------|-------------------|-----------|
| September 30, 2015                |                            |                         |                          |                       |  |                           |                            |                   |           |
| Reserve for loan and lease losses |                            |                         |                          |                       |  |                           |                            |                   |           |
| Balance, beginning of period      | \$ 11,760                  | \$ 10,326               | \$ 4,500                 | \$ 32,234             | \$ 7,008                               | \$ 13,270                 | \$ 4,102                   | \$ 1,868          | \$ 85,068 |
| Charge-offs                       | 1,053                      | 22                      | —                        | 244                   | —                                      | —                         | 104                        | 630               | 2,053     |
| Recoveries                        | 644                        | 315                     | 15                       | 721                   | 357                                    | 174                       | 9                          | 206               | 2,441     |
| Net charge-offs (recoveries)      | 409                        | (293 )                  | (15 )                    | (477 )                | (357 )                                 | (174 )                    | 95                         | 424               | (388 )    |
| Provision (recovery of provision) | 2,688                      | (1,241 )                | (71 )                    | 1,330                 | 278                                    | (423 )                    | (608 )                     | 207               | 2,160     |
| Balance, end of period            | \$ 14,039                  | \$ 9,378                | \$ 4,444                 | \$ 34,041             | \$ 7,643                               | \$ 13,021                 | \$ 3,399                   | \$ 1,651          | \$ 87,616 |
| September 30, 2014                |                            |                         |                          |                       |  |                           |                            |                   |           |
| Reserve for loan and lease losses |                            |                         |                          |                       |  |                           |                            |                   |           |
| Balance, beginning of period      | \$ 11,515                  | \$ 9,657                | \$ 4,212                 | \$ 34,037             | \$ 5,972                               | \$ 12,406                 | \$ 4,093                   | \$ 1,613          | \$ 83,505 |
| Charge-offs                       | 3,228                      | 29                      | —                        | —                     | 4                                      | 17                        | 46                         | 582               | 3,906     |
| Recoveries                        | 863                        | 1,119                   | 137                      | 161                   | 356                                    | 285                       | 93                         | 234               | 3,248     |
| Net charge-offs (recoveries)      | 2,365                      | (1,090 )                | (137 )                   | (161 )                | (352 )                                 | (268 )                    | (47 )                      | 348               | 658       |
| Provision (recovery of provision) | 6,088                      | 250                     | 106                      | (2,734 )              | 133                                    | 278                       | (128 )                     | 560               | 4,553     |
| Balance, end of period            | \$ 15,238                  | \$ 10,997               | \$ 4,455                 | \$ 31,464             | \$ 6,457                               | \$ 12,952                 | \$ 4,012                   | \$ 1,825          | \$ 87,400 |

The following table shows the reserve for loan and lease losses and recorded investment in loans and leases, segregated by class, separated between individually and collectively evaluated for impairment as of September 30, 2015 and December 31, 2014.

| (Dollars in thousands)                                | Commercial<br>agricultural | Auto and<br>light truck | Medium and<br>heavy duty | Aircraft<br>financing | Construction<br>equipment<br>financing | Commercial<br>real estate | Residential<br>real estate | Consumer<br>loans | Total    |
|---|----------------------------|-------------------------|--------------------------|-----------------------|--|---------------------------|----------------------------|-------------------|----------|
| September 30, 2015                                    |                            |                         |                          |                       |  |                           |                            |                   |          |
| Reserve for loan and lease losses                     |                            |                         |                          |                       |  |                           |                            |                   |          |
| Ending balance, individually evaluated for impairment | \$ 2,710                   | \$ —                    | \$ —                     | \$ 617                | \$ —                                   | \$ 22                     | \$ 150                     | \$ —              | \$ 3,499 |
| Ending balance, collectively evaluated for impairment | 11,329                     | 9,378                   | 4,444                    | 33,424                | 7,643                                  | 12,999                    | 3,249                      | 1,651             | 84,117   |
|   | \$ 14,039                  | \$ 9,378                | \$ 4,444                 | \$ 34,041             | \$ 7,643                               | \$ 13,021                 | \$ 3,399                   | \$ 1,651          |          |

Total reserve for loan  
and lease losses