1ST SOURCE CORP
Form 10-K
February 19, 2016
Table of Contents

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2015

OR

o 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

1ST SOURCE CORPORATION
(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, Indiana	46601
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (574) 235-2000

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

Title of each class	Name of each exchange on which registered
Common Stock — without par value	The NASDAQ Stock Market LLC

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

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

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 o No x

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 amendment to this Form 10-K. x

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.

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

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2015 was $644,319,912

The number of shares outstanding of each of the registrant's classes of stock as of February 12, 2016: Common Stock, without par value — 25,880,275 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 2016 Proxy Statement for the 2016 annual meeting of shareholders to be held April 21, 2016, are incorporated by reference into Part III.

Table of Contents

TABLE OF CONTENTS

Table of Contents

Part I

Item 1. Business.

1ST SOURCE CORPORATION

1st Source Corporation, an Indiana corporation incorporated in 1971, is a bank holding company headquartered in South Bend, Indiana that provides, through its subsidiaries (collectively referred to as “1st Source”, “we”, and “our”), a broad array of financial products and services. 1st Source Bank (“Bank”), its banking subsidiary, offers commercial and consumer banking services, trust and investment management services, and insurance to individual and business clients through most of our 81 banking center locations in 17 counties in Indiana and Michigan. 1st Source Bank’s Specialty Finance Group, with 22 locations nationwide, offers specialized financing services for new and used private and cargo aircraft, automobiles and light trucks for leasing and rental agencies, medium and heavy duty trucks and construction equipment. While our lending portfolio is concentrated in certain equipment types, we serve a diverse client base. We are not dependent upon any single industry or client. At December 31, 2015, we had consolidated total assets of $5.19 billion, total loans and leases of $3.99 billion, total deposits of $4.14 billion, and total shareholders’ equity of $644.05 million.

Our principal executive office is located at 100 North Michigan Street, South Bend, Indiana 46601 and our telephone number is (574) 235-2000. Access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports is available, free of charge, at www.1stsource.com soon after the material is electronically filed with or furnished to the Securities and Exchange Commission (SEC).

1ST SOURCE BANK

1st Source Bank is a wholly owned subsidiary of 1st Source Corporation that offers a broad range of consumer and commercial banking services through its lending operations, retail branches, and fee based businesses.

Commercial, Agricultural, and Real Estate Loans — 1st Source Bank provides commercial, small business, agricultural, and real estate loans to primarily privately owned business clients mainly located within our regional market area. Loans are made for a wide variety of general corporate purposes, including financing for industrial and commercial properties, financing for equipment, inventories and accounts receivable, and acquisition financing. Other services include commercial leasing, treasury management services and retirement planning services.

Consumer Services — 1st Source Bank provides a full range of consumer banking products and services through our banking centers and at 1stsource.com. In a number of our markets 1st Source also offers insurance products through 1st Source Insurance offices. The traditional banking services include checking and savings accounts, certificates of deposits and Individual Retirement Accounts. 1st Source offers a full line of on-line and mobile banking products which includes bill payment. As an added convenience, a strategically located Automated Teller Machine network serves our customers and supports the debit and credit card programs of the bank. Consumers also have the ability to obtain consumer loans, real estate loans and lines of credit in any of our banking centers or on-line. Finally, 1st Source offers a variety of financial planning, financial literacy and other consultative services to our customers.

Trust Services — 1st Source Bank provides a wide range of trust, investment, agency, and custodial services for individual, corporate, and not-for-profit clients. These services include the administration of estates and personal trusts, as well as the management of investment accounts for individuals, employee benefit plans, and charitable foundations.

Specialty Finance Group Services — 1st Source Bank, through its Specialty Finance Group, provides a broad range of comprehensive equipment loan and lease finance products addressing the financing needs of a broad array of companies. This group can be broken down into four areas: new and used aircraft; auto and light trucks; construction equipment; and medium and heavy duty trucks.

Aircraft financing consists of financings for new and used general aviation aircraft (including helicopters) for private and corporate aircraft users, aircraft distributors and dealers, air charter operators, air cargo carriers, and other aircraft operators. We have for many years, on a limited and selective basis, provided international aircraft financing, primarily in Mexico and Brazil. Aircraft finance receivables generally range from $500,000 to $25 million with fixed or variable interest rates and terms of one to ten years.

The auto and light truck division (including specialty vehicles such as shuttle buses, step vans, motor coach's and funeral cars) consists of fleet financings to automobile rental and leasing companies, light truck rental and leasing companies, and single to fleet financing for users of special purpose vehicles. The auto and light truck finance receivables generally range from $100,000 to $20 million with fixed or variable interest rates and terms of one to five years.

Construction equipment financing includes financing of equipment (i.e., asphalt and concrete plants, bulldozers, excavators, cranes, loaders, and trash and recycling equipment, etc.) to the construction industry. Construction equipment finance receivables generally range from $50,000 to $15 million with fixed or variable interest rates and terms of one to seven years.

Table of Contents

The medium and heavy duty truck division provides fleet financing for highway tractors and trailers and delivery trucks to the commercial trucking industry. Medium and heavy duty truck finance receivables generally range from $500,000 to $15 million with fixed or variable interest rates and terms of three to seven years.

We also generate equipment rental income through the leasing of construction equipment, medium and heavy duty trucks, automobiles, and other equipment to clients through operating leases.

SPECIALTY FINANCE GROUP SUBSIDIARIES

The Specialty Finance Group also consists of separate wholly owned subsidiaries of 1st Source Bank which include: Michigan Transportation Finance Corporation, 1st Source Specialty Finance, Inc., SFG Aircraft, Inc., 1st Source Intermediate Holding, LLC, SFG Commercial Aircraft Leasing, Inc., and SFG Equipment Leasing Corporation I.

1ST SOURCE INSURANCE, INC.

1st Source Insurance, Inc. is a wholly owned subsidiary of 1st Source Bank that provides insurance products and services to individuals and businesses covering corporate and personal property, casualty insurance, and individual and group health and life insurance. 1st Source Insurance, Inc. has ten offices.

1ST SOURCE CORPORATION INVESTMENT ADVISORS, INC.

1st Source Corporation Investment Advisors, Inc. (Investment Advisors) is a wholly owned subsidiary of 1st Source Bank that provides investment advisory services for trust and investment clients of 1st Source Bank and to Wasatch Advisors, Inc., the investment advisor of the Wasatch Mutual Fund family. Investment Advisors is registered as an investment advisor with the Securities and Exchange Commission under the Investment Advisors Act of 1940. Investment Advisors serves strictly in an advisory capacity and, as such, does not hold any client securities.

OTHER CONSOLIDATED SUBSIDIARIES

We have other subsidiaries that are not significant to the consolidated entity.

1ST SOURCE MASTER TRUST

Our unconsolidated subsidiary includes 1st Source Master Trust. This subsidiary was created for the purpose of issuing $57.00 million of trust preferred securities and lending the proceeds to 1st Source. We guarantee, on a limited basis, payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities.

COMPETITION

The activities in which we and the Bank engage in are highly competitive. Our businesses and the geographic markets we serve require us to compete with other banks, some of which are affiliated with large bank holding companies headquartered outside of our principal market. We generally compete on the basis of client service and responsiveness to client needs, available loan and deposit products, the rates of interest charged on loans and leases, the rates of interest paid for funds, other credit and service charges, the quality of services rendered, the convenience of banking facilities, and in the case of loans and leases to large commercial borrowers, relative lending limits.

In addition to competing with other banks within our primary service areas, the Bank also competes with other financial service companies, such as credit unions, industrial loan associations, securities firms, insurance companies, small loan companies, finance companies, mortgage companies, real estate investment trusts, certain governmental agencies, credit organizations, and other enterprises.

Additional competition for depositors’ funds comes from United States Government securities, private issuers of debt obligations, and suppliers of other investment alternatives for depositors. Many of our non-bank competitors are not subject to the same extensive Federal and State regulations that govern bank holding companies and banks. Such non-bank competitors may, as a result, have certain advantages over us in providing some services.

We compete against these financial institutions by being convenient to do business with, and by taking the time to listen and understand our clients’ needs. We deliver personalized, one-on-one banking through knowledgeable local members of the community always keeping the clients' best interest in mind while offering a full array of products and highly personalized services. We rely on our history and our reputation in northern Indiana dating back to 1863.

EMPLOYEES

At December 31, 2015, we had approximately 1,150 employees on a full-time equivalent basis. We provide a wide range of employee benefits and consider employee relations to be good.

4

Table of Contents

REGULATION AND SUPERVISION

General — 1st Source and the Bank are extensively regulated under Federal and State law. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in applicable laws or regulations may have a material effect on our business and our prospective business. Our operations may be affected by legislative changes and by the policies of various regulatory authorities. We are unable to predict the nature or the extent of the effects on our business and earnings that fiscal or monetary policies, economic controls, or new Federal or State legislation may have in the future.

We are a registered bank holding company under the Bank Holding Company Act of 1956, as amended (BHCA), and, as such, we are subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (Federal Reserve). We are required to file annual reports with the Federal Reserve and to provide the Federal Reserve such additional information as it may require.

The Bank, as an Indiana state bank and member of the Federal Reserve System, is supervised by the Indiana Department of Financial Institutions (DFI) and the Federal Reserve. As such, 1st Source Bank is regularly examined by and subject to regulations promulgated by the DFI and the Federal Reserve. Because the Federal Deposit Insurance Corporation (FDIC) provides deposit insurance to the Bank, we are also subject to supervision and regulation by the FDIC (even though the FDIC is not our primary Federal regulator).

Bank Holding Company Act — Under the BHCA our activities are limited to business so closely related to banking, managing, or controlling banks as to be a proper incident thereto. We are also subject to capital requirements applied on a consolidated basis in a form substantially similar to those required of the Bank. The BHCA also requires a bank holding company to obtain approval from the Federal Reserve before (i) acquiring, or holding more than 5% voting interest in any bank or bank holding company, (ii) acquiring all or substantially all of the assets of another bank or bank holding company, or (iii) merging or consolidating with another bank holding company.

The BHCA also restricts non-bank activities to those which, by statute or by Federal Reserve regulation or order, have been identified as activities closely related to the business of banking or of managing or controlling banks. As discussed below, the Gramm-Leach-Bliley Act (GLBA), which was enacted in 1999, established a new type of bank holding company known as a “financial holding company” that has powers that are not otherwise available to bank holding companies.

The Federal Deposit Insurance Corporation Improvement Act of 1991 — The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) was adopted to address a wide variety of banking issues. In general, FDICIA provided for the recapitalization of the former Bank Insurance Fund, deposit insurance reform, including the implementation of risk-based deposit insurance premiums, the establishment of five capital levels for financial institutions (“well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized”) that would impose more scrutiny and restrictions on less capitalized institutions, along with a number of other supervisory and regulatory issues. At December 31, 2015, the Bank was categorized as “well capitalized,” meaning that our total risk-based capital ratio exceeded 10.00%, our Tier 1 risk-based capital ratio exceeded 8.00%, our common equity Tier-1 risk-based capital ratio exceeded 6.50%, our leverage ratio exceeded 5.00%, and we are not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure.

FDIC Deposit Insurance Assessments —The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which was signed into law on July 21, 2010, changes how the FDIC calculates deposit insurance premiums payable by insured depository institutions. The Dodd-Frank Act directs the FDIC to calculate the deposit insurance assessments payable by each insured depository institution based generally upon the institution’s average total consolidated assets minus its average tangible equity during the assessment period. Previously, an institution's assessments were based on the amount of its insured deposits. The minimum deposit insurance fund rate will increase from 1.15% to 1.35% by September 30, 2020, and the cost of the increase will be borne by depository institutions with assets of $10 billion or more.

The Dodd-Frank Act also provides the FDIC with discretion to determine whether to pay rebates to insured depository institutions when its deposit insurance reserves exceed certain thresholds. Previously, the FDIC was required to give rebates to depository institutions equal to the excess once the reserve ratio exceeded 1.50%, and was required to rebate 50% of the excess over 1.35% but not more than 1.5% of insured deposits. The FDIC adopted a final rule on February 7, 2011 that implements these provisions of the Dodd-Frank Act.

Table of Contents

Emergency Economic Stabilization Act of 2008 — The Emergency Economic Stabilization Act of 2008 (EESA), among other things, temporarily increased the standard maximum deposit insurance amount from $100,000 to $250,000. This temporary increase in the scope of deposit insurance coverage was originally set to expire on December 31, 2013, but the Dodd-Frank Act made this temporary increase permanent. Under the Troubled Asset Relief Program established by EESA, the U.S. Treasury Department (Treasury) announced a Capital Purchase Program (CPP). CPP was designed to encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and support the U.S. economy. Under the program, Treasury could purchase up to $250 billion of senior preferred shares on standardized terms as described in the program’s term sheet. The program was available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities that timely submitted applications to Treasury. EESA provided for Treasury to determine an applicant’s eligibility to participate in the CPP after consulting with the appropriate federal banking agency.

Treasury approved 1st Source's application to participate in the CPP and on January 23, 2009, 1st Source issued to Treasury pursuant to the CPP preferred stock valued at $111.00 million and a warrant to acquire 837,947 shares of its common stock. The warrant was exercisable at any time during the ten-year period following issuance at an exercise price of $19.87 per share. On December 29, 2010, 1st Source redeemed all of the preferred stock issued to the Treasury under CPP for $111.68 million, which included accrued and unpaid dividends payable to Treasury on the preferred stock. On March 8, 2011, 1st Source repurchased the common stock warrant for $3.75 million.

Securities and Exchange Commission (SEC) and The NASDAQ Stock Market (NASDAQ) — We are under the jurisdiction of the SEC and certain state securities commissions for matters relating to the offering and sale of our securities and our investment advisory services. We are subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. We are listed on the NASDAQ Global Select Market under the trading symbol “SRCE,” and we are subject to the rules of NASDAQ for listed companies.

Interstate Branching — Congress enacted the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) to allow bank holding companies to expand, by acquiring existing banks, into all states, even those which had theretofore restricted entry. The legislation also authorized a bank to open de novo branches in other states, but only to the extent that the law of the bank’s home state, as well as the law of the state where the branch was to be located, permitted an out-of-state bank to open a de novo branch. The Interstate Act also authorized, subject to future action by individual states, a bank holding company to convert its subsidiary banks located in different states under a single charter.

The Dodd-Frank Act amended the Interstate Act by expanding the authority of a state or national bank to open offices in other states. A state or national bank may now open a de novo branch in another state if the law of the state where the branch is to be located would permit a state bank chartered by that state to open the branch. This amendment repealed the restriction under the Interstate Act that permitted an out-of-state bank to open a de novo branch in another state only if the bank’s home state and the state where the branch was to be located had each enacted reciprocal de novo interstate branching laws.

Gramm-Leach-Bliley Act of 1999 — The GLBA is intended to modernize the banking industry by removing barriers to affiliation among banks, insurance companies, the securities industry, and other financial service providers. It provides financial organizations with the flexibility of structuring such affiliations through a holding company structure or through a financial subsidiary of a bank, subject to certain limitations. The GLBA establishes a new type of bank holding company, known as a financial holding company, which may engage in an expanded list of activities that are “financial in nature,” which include securities and insurance brokerage, securities underwriting, insurance underwriting, and merchant banking. The GLBA also sets forth a system of functional regulation that makes the Federal Reserve the “umbrella supervisor” for holding companies, while providing for the supervision of the holding company’s subsidiaries by other Federal and state agencies. A bank holding company may not become a financial holding company if any of its subsidiary financial institutions are not well-capitalized or well-managed. Further, each bank subsidiary of the holding company must have received at least a satisfactory Community Reinvestment Act (CRA) rating. The GLBA also expands the types of financial activities a national bank may conduct through a financial subsidiary, addresses state regulation of insurance, generally prohibits unitary thrift holding companies organized after May 4, 1999 from participating in new activities that are not financial in nature, provides privacy protection for nonpublic customer information of financial institutions, modernizes the Federal Home Loan Bank system, and makes miscellaneous regulatory improvements. The Federal Reserve and the Secretary of the Treasury must coordinate their supervision regarding approval of new financial activities to be conducted through a financial holding company or through a financial subsidiary of a bank. While the provisions of the GLBA regarding activities that may be conducted through a financial subsidiary directly apply only to national banks, those provisions indirectly apply to state-chartered banks. In addition, the Bank is subject to other provisions of the GLBA, including those relating to CRA and privacy, regardless of whether we elect to become a financial holding company or to conduct activities through a financial subsidiary. We do not currently intend to file notice with the Board to become a financial holding company or to engage in expanded financial activities through a financial subsidiary.

Table of Contents

Financial Privacy — In accordance with the GLBA, Federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about customers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy provisions of the GLBA affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. We are also subject to various state laws that generally require us to notify any customer whose personal financial information may have been released to an unauthorized person as the result of a breach of our data security policies and procedures.

USA Patriot Act of 2001 — The USA Patriot Act of 2001 (USA Patriot Act) was signed into law following the terrorist attacks of September 11, 2001. The USA Patriot Act is comprehensive anti-terrorism legislation that, among other things, substantially broadened the scope of anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations on financial institutions.

The regulations adopted by the Treasury under the USA Patriot Act require financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering, and terrorist financing. Additionally, the regulations require that we, upon request from the appropriate Federal regulatory agency, provide records related to anti-money laundering, perform due diligence of private banking and correspondent accounts, establish standards for verifying customer identity, and perform other related duties.

Failure of a financial institution to comply with the USA Patriot Act’s requirements could have serious legal and reputational consequences for the institution.

Regulations Governing Capital Adequacy — The Federal bank regulatory agencies use capital adequacy guidelines in their examination and regulation of bank holding companies and banks. If capital falls below the minimum levels established by these guidelines, a bank holding company or bank will be required to submit an acceptable plan for achieving compliance with the capital guidelines and will be subject to denial of applications and appropriate supervisory enforcement actions. The various regulatory capital requirements that we are subject to are disclosed in Part II, Item 8, Financial Statements and Supplementary Data — Note 20 of the Notes to Consolidated Financial Statements.

Community Reinvestment Act — The Community Reinvestment Act of 1977 requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal banking regulators must evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those banks. Federal banking regulators are required to consider a financial institution’s performance in these areas as they review applications filed by the institution to engage in mergers or acquisitions or to open a branch or facility.

Regulations Governing Extensions of Credit — The Bank is subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to 1st Source or our subsidiaries, or investments in our securities and on the use of our securities as collateral for loans to any borrowers. These regulations and restrictions may limit our ability to obtain funds from the Bank for our cash needs, including funds for acquisitions and for payment of dividends, interest and operating expenses. Further, the BHCA, certain regulations of the Federal Reserve, state laws and many other Federal laws govern the extensions of credit and generally prohibit a bank from extending credit, engaging in a lease or sale of property, or furnishing services to a customer on the condition that the customer obtain additional services from the bank’s holding company or from one of its subsidiaries.

The Bank is also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders, or any related interest of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, and subject to credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with non affiliates, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. The Bank is also subject to certain lending limits and restrictions on overdrafts to such persons.

Reserve Requirements — The Federal Reserve requires all depository institutions to maintain reserves against their transaction account deposits. For 2016, the Bank must maintain reserves of 3.00% against net transaction accounts greater than $15.20 million and up to $110.20 million (subject to adjustment by the Federal Reserve) and reserves of

10.00% must be maintained against that portion of net transaction accounts in excess of $110.20 million. These amounts are indexed to inflation and adjusted annually by the Federal Reserve.

Dividends — The ability of the Bank to pay dividends is limited by state and Federal laws and regulations that require the Bank to obtain the prior approval of the DFI and the Federal Reserve Bank of Chicago before paying a dividend that, together with other dividends it has paid during a calendar year, would exceed the sum of its net income for the year to date combined with its retained net income for the previous two years. The amount of dividends the Bank may pay may also be limited by certain covenant agreements and by the principles of prudent bank management. See Part II, Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities for further discussion of dividend limitations.

Table of Contents

Monetary Policy and Economic Control — The commercial banking business in which we engage is affected not only by general economic conditions, but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowing, availability of borrowing at the “discount window,” open market operations, the imposition of changes in reserve requirements against member banks’ deposits and assets of foreign branches, and the imposition of, and changes in, reserve requirements against certain borrowings by banks and their affiliates are some of the instruments of monetary policy available to the Federal Reserve. These monetary policies are used in varying combinations to influence overall growth and distributions of bank loans, investments, and deposits, and such use may affect interest rates charged on loans and leases or paid on deposits. The monetary policies of the Federal Reserve have had a significant effect on the operating results of commercial banks and are expected to do so in the future. The monetary policies of the Federal Reserve are influenced by various factors, including economic growth, inflation, unemployment, short-term and long-term changes in the international trade balance, and in the fiscal policies of the U.S. Government. Future monetary policies and the effect of such policies on our future business and earnings, and the effect on the future business and earnings of the Bank cannot be predicted.

Sarbanes-Oxley Act of 2002 — The Sarbanes-Oxley Act of 2002 (SOA) includes provisions intended to enhance corporate responsibility and protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws, and which increase penalties for accounting and auditing improprieties at public traded companies. The SOA generally applies to all companies that file or are required to file periodic reports with the SEC under the Exchange Act.

Among other things, the SOA creates the Public Company Accounting Oversight Board as an independent body subject to SEC supervision with responsibility for setting auditing, quality control, and ethical standards for auditors of public companies. The SOA also requires public companies to make faster and more-extensive financial disclosures, requires the chief executive officer and the chief financial officer of public companies to provide signed certifications as to the accuracy and completeness of financial information filed with the SEC, and provides enhanced criminal and civil penalties for violations of the Federal securities laws.

The SOA also addresses functions and responsibilities of audit committees of public companies. The statute, by mandating certain stock exchange listing rules, makes the audit committee directly responsible for the appointment, compensation, and oversight of the work of the company’s outside auditor, and requires the auditor to report directly to the audit committee. The SOA authorizes each audit committee to engage independent counsel and other advisors, and requires a public company to provide the appropriate funding, as determined by its audit committee, to pay the company’s auditors and any advisors that its audit committee retains. The SOA also requires public companies to prepare an internal control report and assessment by management, along with an attestation to this report prepared by the company’s independent registered public accounting firm, in their annual reports to stockholders.

Secure and Fair Enforcement for Mortgage Licensing Act — The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act) establishes a nationwide licensing and registration system for mortgage loan originators. The S.A.F.E. Act requires an employee of a bank, savings association or credit union and certain of their subsidiaries that are regulated by a federal banking agency (agency-regulated institutions) who acts as a residential mortgage loan originator to register with the Nationwide Mortgage Licensing System and Registry (NMLS), obtain a unique identifier, and maintain this registration.

The federal banking agencies adopted a final rule in 2010 to implement these provisions. The final rule requires, among other things, that a loan originator submit to the NMLS certain information concerning his or her personal history and experience, undergo an FBI criminal background check, and authorize the NMLS to obtain information related to any administrative, civil, or criminal findings by any governmental agency regarding the loan originator.

Consumer Financial Protection Laws — The Bank is subject to a number of federal and state consumer financial protection laws and regulations that extensively govern its transactions with consumers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, and the Service Members Civil Relief Act. 1st Source Bank must also comply with applicable state usury laws and other laws prohibiting unfair and deceptive acts and practices. These laws, among other things, require disclosures of the cost of credit and the terms of deposit accounts, prohibit discrimination in credit transactions, regulate the use of credit report information, restrict the Bank's ability to raise interest rates and subject the Bank to substantial regulatory oversight. Violations of these laws may expose us to liability from potential lawsuits brought by affected customers. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce these consumer financial protection laws, in which case we may be subject to regulatory sanctions, civil money penalties, and customer rescission rights. Failure to comply with these laws may also cause the Federal Reserve or DFI to deny approval of any applications we may file to engage in merger and acquisition transactions with other financial institutions.

Table of Contents

Dodd-Frank Wall Street Reform and Consumer Protection Act — The Dodd-Frank Act, which was signed into law in 2010, significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes provisions affecting large and small financial institutions alike, including several provisions that will profoundly affect how community banks, thrifts, and small bank and thrift holding companies will be regulated in the future. Among other things, these provisions abolish the Office of Thrift Supervision and transfer its functions to the other federal banking agencies, relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, and impose new capital requirements on bank and thrift holding companies. The Dodd-Frank Act also includes several corporate governance provisions that apply to all public companies, not just financial institutions. These include provisions mandating certain disclosures regarding executive compensation and provisions addressing proxy access by shareholders.

The Dodd-Frank Act also establishes the Consumer Financial Protection Bureau (CFPB) as an independent entity within the Federal Reserve. In July 2011, the CFPB assumed primary responsibility for administering substantially all of the consumer compliance regulations, including Regulation Z issued under the Truth in Lending Act and Regulation X issued under the Real Estate Settlement Procedures Act, formerly administered by other federal agencies. The CFPB also has the authority to promulgate consumer protection regulations that will apply to all entities, including banks, that offer consumer financial services or products. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards, and pre-payment penalties.

The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, including some that may affect our business in substantial and unpredictable ways. We have incurred higher operating costs in complying with the Dodd -Frank Act, and we expect that these higher costs will continue for the foreseeable future. Our management continues to monitor the ongoing implementation of the Dodd-Frank Act and as new regulations are issued, will assess their effect on our business, financial condition, and results of operations.

The Volcker Rule — The Dodd-Frank act prohibits banks and their affiliates from engaging in proprietary trading and from investing and sponsoring hedge funds and private equity funds. The statutory provision implementing these restrictions is commonly called the “Volcker Rule.” To implement the Volcker Rule, federal regulators issued final rules in December 2013 that were to become effective April 2014. The Federal Reserve subsequently issued an order extending the period that institutions have to conform their activities to the requirements of the Volcker Rule to July 21, 2015, and extended the compliance date for banks to conform their investments in certain “legacy covered funds” until July 21, 2016. These final rules exempt the Bank, as a bank with less than $10 billion in total consolidated assets that does not engage in any covered activities other than trading in certain government, agency, state or municipal obligations, from any significant compliance obligations under the Volcker Rule. We are continuing to evaluate the effects of the Volcker Rules on our business, but we do not currently anticipate that the Volcker rule will have a material effect on our business, financial condition and results of operations.

Capital Standards — In July 2013, the Federal Reserve and other federal banking agencies approved final rules implementing the Basel Committee on Banking Supervision's capital guidelines for all U.S. banks and for bank holding companies with greater than $500 million in assets. Under these final rules, minimum requirements will increase for both the quantity and quality of capital held by 1st Source and the Bank. The rules include a new common equity Tier 1 capital ratio of 4.5%, a minimum Tier 1 capital ratio of 6.0%, a total capital ratio of 8.0%, and a minimum leverage ratio of 4.0%. The final rules also require a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement will be phased in over three years beginning in 2016. The capital buffer requirement effectively raises the minimum required common equity Tier 1 capital ratio to 7.0%, the Tier 1 capital ratio to 8.5%, and the total capital ratio to 10.5% on a fully phased-in basis.

The final rules also increase the required capital for certain categories of assets, including higher-risk construction real estate loans and certain exposures related to securitizations. The final rules do not, however, adopt the changes in the proposed rule to the risk weights assigned to certain mortgage loan assets. The final rules instead adopt the risk weights for residential mortgages under the existing general risk-based capital rules, which assign a risk weight of either 50% (for most first-lien exposures) or 100% for other residential mortgage exposures. Similarly, the final rules do not adopt the proposed rule's elimination of Tier 1 treatment of trust preferred securities for banking organizations with less than $15 billion in assets as of December 31, 2010. Instead, the final rules permit these banking organizations to retain non-qualifying Tier 1 capital trust preferred securities issued prior to May 19, 2010, subject generally to a limit of 25% of Tier 1 capital.

These new minimum capital ratios became effective for us on January 1, 2015 and will be fully phased-in on January 1, 2019. Management believes that, as of December 31, 2015, 1st Source and the Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect.

Table of Contents

Liquidity Requirements — Historically, the regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III final framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio, or LCR, is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio, or NSFR, is designed to promote more medium and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements are expected to incentivize banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source.

In September 2015, the federal bank regulators approved final rules implementing the LCR for advanced approaches banking organizations (i.e,. banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure) and a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approach banking organizations, neither of which would apply to 1st Source or the Bank. The federal bank regulators have not yet proposed rules to implement the NSFR, but the Federal Reserve has stated its intent to adopt a version of this measure as well.

Pending Legislation — Because of concerns relating to competitiveness and the safety and soundness of the banking industry, Congress often considers a number of wide-ranging proposals for altering the structure, regulation, and competitive relationships of the nation's financial institutions. We cannot predict whether or in what form any proposals will be adopted or the extent to which our business may be affected.

Item 1A. Risk Factors.

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that we believe affect us are described below. See "Forward Looking Statements" under Item 7 of this report for a discussion of other important factors that can affect our business.

Credit Risks

We are subject to credit risks relating to our loan and lease portfolios — We have certain lending policies and procedures in place that are designed to optimize loan and lease income within an acceptable level of risk. Our management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing our management with frequent reports related to loan and lease production, loan quality, concentrations of credit, loan and lease delinquencies, and nonperforming and potential problem loans and leases. Diversification in the loan and lease portfolios is a means of managing risk associated with fluctuations and economic conditions.

We maintain an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to our management. The loan and lease review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as our policies and procedures.

Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. We seek to minimize these risks through our underwriting standards. We obtain financial information and perform credit risk analysis on our customers. Credit criteria may include, but are not limited to, assessments of income, cash flows, collateral, and net worth; asset ownership; bank and trade credit references; credit bureau reports; and operational history.

Commercial real estate or equipment loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and generate positive cash flows. Our management examines current and projected cash flows of the borrower to determine the ability of the borrower to repay their obligations as agreed. Underwriting standards are designed to promote relationship banking rather than transactional banking. Most commercial and industrial loans are secured by the assets being financed or other business assets; however, some loans may be made on an unsecured basis. Our credit policy sets different maximum exposure limits both by business sector and our current and historical relationship and previous experience with each customer.

We offer both fixed-rate and adjustable-rate consumer mortgage loans secured by properties, substantially all of which are located in our primary market area. Adjustable-rate mortgage loans help reduce our exposure to changes in interest rates; however, during periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase as a result of repricing and the increased payments required from the borrower. Additionally, some residential mortgages are sold into the secondary market and serviced by our principal banking subsidiary, 1st Source Bank.

Table of Contents

Consumer loans are primarily all other non-real estate loans to individuals in our regional market area. Consumer loans can entail risk, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets. In these cases, any repossessed collateral may not provide an adequate source of repayment of the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness, or personal bankruptcy.

The 1st Source Specialty Finance Group loan and lease portfolio consists of commercial loans and leases secured by construction and transportation equipment, including aircraft, autos, trucks, and vans. Finance receivables for this Group generally provide for monthly payments and may include prepayment penalty provisions.

Our construction and transportation related businesses could be adversely affected by slowdowns in the economy. Clients who rely on the use of assets financed through the Specialty Finance Group to produce income could be negatively affected, and we could experience substantial loan and lease losses. By the nature of the businesses these clients operate in, we could be adversely affected by rapid increases and decreases of fuel costs. Since some of the relationships in these industries are large, a slowdown could have a significant adverse impact on our performance.

Our construction and transportation related businesses could be adversely impacted by the negative effects caused by high fuel costs, terrorist and other potential attacks, and other destabilizing events. These factors could contribute to the deterioration of the quality of our loan and lease portfolio, as they could have a negative impact on the travel and transportation sensitive businesses for which our specialty finance businesses provide financing.

Our aircraft portfolio has foreign exposure, particularly in Mexico and Brazil. We establish exposure limits for each country through a centralized oversight process, and in consideration of relevant economic, political, social and legal risks. We monitor exposures closely and adjust our country limits in response to changing conditions. Currency fluctuations could have a negative impact on our client's cost of paying dollar denominated debts and, as a result, we could experience higher delinquency in this portfolio.

In addition, our leasing and equipment financing activity is subject to the risk of cyclical downturns, industry concentration and clumping, and other adverse economic developments affecting these industries and markets. This area of lending, with transportation in particular, is dependent upon general economic conditions and the strength of the travel, construction, and transportation industries.

Our reserve for loan and lease losses may prove to be insufficient to absorb probable losses in our loan and lease portfolio — In the financial services industry, there is always a risk that certain borrowers may not repay borrowings. The determination of the appropriate level of the reserve for loan and lease losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Our reserve for loan and lease losses may not be sufficient to cover the loan and lease losses that we may actually incur. If we experience defaults by borrowers in any of our businesses, our earnings could be negatively affected. Changes in local economic conditions could adversely affect credit quality, particularly in our local business loan and lease portfolio. Changes in national or international economic conditions could also adversely affect the quality of our loan and lease portfolio and negate, to some extent, the benefits of national or international diversification through our Specialty Finance Group's portfolio. In addition, bank regulatory agencies periodically review our reserve for loan and lease losses and may require an increase in the provision for loan and lease losses or the recognition of further loan or lease charge-offs based upon their judgments, which may be different from ours.

The soundness of other financial institutions could adversely affect us — Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due us. Any such losses could have a material adverse effect on our financial condition and results of operations.

11

Table of Contents

Market Risks

Fluctuations in interest rates could reduce our profitability and affect the value of our assets — Like other financial institutions, we are subject to interest rate risk. Our primary source of income is net interest income, which is the difference between interest earned on loans and leases and investments, and interest paid on deposits and borrowings. We expect that we will periodically experience imbalances in the interest rate sensitivities of our assets and liabilities and the relationships of various interest rates to each other. Over any defined period of time, our interest-earning assets may be more sensitive to changes in market interest rates than our interest-bearing liabilities, or vice-versa. In addition, the individual market interest rates underlying our loan and lease and deposit products may not change to the same degree over a given time period. In any event, if market interest rates should move contrary to our position, earnings may be negatively affected. In addition, loan and lease volume and quality and deposit volume and mix can be affected by market interest rates as can the businesses of our clients. Changes in levels of market interest rates could have a material adverse effect on our net interest spread, asset quality, origination volume, and overall profitability.

Market 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, may negatively affect our ability to originate loans and leases, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately could affect our earnings.

Adverse changes in economic conditions could impair our financial condition and results of operations — We are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, unemployment, and the strength of the U.S. economy and the local economies in which we operate, all of which are beyond our control. A deterioration in economic conditions could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for our products and services.

Changes in economic conditions may negatively impact the fees generated by our wealth management and trust business — Wealth management and trust fees are largely based on the size of client relationships and the market value of assets held under management. Changes in general economic conditions and in the financial and securities markets may negatively impact the value of our clients' wealth management accounts and the market value of assets held under management. Market declines, reductions in the value of our clients' accounts, and the loss of wealth management clients may negatively impact the fees generated by our wealth management and trust business and could have an adverse effect on our business, financial condition and results of operations.

Liquidity Risks

We could experience an unexpected inability to obtain needed liquidity — Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits, and to take advantage of interest rate market opportunities and is essential to a financial institution’s business. The ability of a financial institution to meet its current financial obligations is a function of its balance sheet structure, its ability to liquidate assets, and its access to alternative sources of funds. We seek to ensure our funding needs are met by maintaining a level of liquidity through asset and liability management. If we become unable to obtain funds when needed, it could have a material adverse effect on our business, financial condition, and results of operations. Additionally, under Indiana law governing the collateralization of public fund deposits, the Indiana Board for Depositories determines which financial institutions are required to pledge collateral based on the strength of their financial ratings. We have been informed that no collateral is required for our public fund deposits. However, the Board of Depositories could alter this requirement in the future and adversely impact our liquidity.

We rely on dividends from our subsidiaries — Our parent company, 1st Source Corporation, receives substantially all of its revenue from dividends from our subsidiaries. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that our subsidiaries may pay to our parent company. In the event our subsidiaries are unable to pay dividends to our parent company, we may not be able to service debt, pay obligations or pay dividends on our common stock. The inability to receive dividends from our subsidiaries could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

Operational Risks

We are dependent upon the services of our management team — Our future success and profitability is substantially dependent upon our management and the banking acumen of our senior executives. We believe that our future results will also depend in part upon our ability to attract and retain highly skilled and qualified management. We are especially dependent on a limited number of key management personnel, many of whom do not have employment agreements with us. The loss of the chief executive officer and other senior management and key personnel could have a material adverse impact on our operations because other officers may not have the experience and expertise to readily replace these individuals. Many of these senior officers have primary contact with our clients and are important in maintaining personalized relationships with our client base. The unexpected loss of services of one or more of these key employees could have a material adverse effect on our operations and possibly result in reduced revenues if we were unable to find suitable replacements promptly. Competition for senior personnel is intense, and we may not be successful in attracting and retaining such personnel. Changes in key personnel and their responsibilities may be disruptive to our businesses and could have a material adverse effect on our businesses, financial condition, and results of operations.

Technology security breaches — Information security risks have increased due to the sophistication and activities of organized crime, hackers, terrorists and other external parties and the use of online, telephone, and mobile banking channels by clients. Any compromise of our security could deter our clients from using our banking services. We rely on security systems to provide the protection and authentication necessary to effect secure transmission of data against damage by theft, fire, power loss, telecommunications failure or similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms, and other disruptive problems caused by hackers. Computer break-ins, phishing and other disruptions of customer or vendor systems could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure. We maintain a cyber insurance policy that is designed to cover a majority of loss resulting from cyber security breaches. These precautions may not protect our systems from compromises or breaches of our security measures that could result in damage to our reputation and business.

We depend on the services of a variety of third party vendors to meet data processing and communication needs and we have contracted with third parties to run their proprietary software on our behalf. While we perform reviews of security controls instituted by the vendor in accordance with industry standards and institute our own internal security controls, we rely on continued maintenance of the controls by the outside party to safeguard our customer data. Additionally, we issue debit cards which are susceptible to compromise at the point of sale via the physical terminal through which transactions are processed and by other means of hacking. The security and integrity of these transactions are dependent upon the retailers' vigilance and willingness to invest in technology and upgrades. Issuing debit cards to our clients exposes us to potential losses which, in the event of a data breach at one or more major retailers may adversely affect our business, financial condition, and results of operations.

We continually encounter technological change — The financial services industry is constantly undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better service clients and reduce costs. Our future success depends, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands, as well as create additional efficiencies within our operations. Many of our large competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services quickly or be successful in marketing these products and services to our clients. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

Our accounting estimates and risk management processes rely on analytical and forecasting models — The processes we use to estimate our probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the reserve for loan and lease losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

We have opened new banking centers — We are selectively expanding our banking center network within our market footprint. Executing this expansion requires a significant investment in both financial and personnel resources. Lower than expected loan and deposit growth can decrease anticipated revenues and net income generated by those banking centers, which could have a material adverse effect on our business, financial condition and results of operations.

Legal/Compliance Risks

We are subject to extensive government regulation and supervision — Our operations are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not security holders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible change. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulation or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs and limit the types of financial services and products we may offer. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

Changes in accounting standards could impact reported earnings — Current accounting and tax rules, standards, policies and interpretations influence the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies and interpretations are constantly evolving and may change significantly over time. Events that may not have a direct impact on us, such as bankruptcy of major U.S. companies, have resulted in legislators, regulators, and authoritative bodies, such as the Financial Accounting Standards Board, the Securities and Exchange Commission, the Public Company Accounting Oversight Board and various taxing authorities, responding by adopting and/or proposing substantive revision to laws, regulations, rules, standards, policies and interpretations. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. A change in accounting standards may adversely affect our reported financial condition and results of operations.

Substantial ownership concentration — Our directors, executive officers and 1st Source Bank, as trustee, collectively hold a significant ownership concentration of our common shares. Due to this significant level of ownership among our affiliates, our directors, executive officers, and 1st Source Bank, as trustee, may be able to influence the outcome of director elections or impact significant transactions, such as mergers or acquisitions, or any other matter that might otherwise be favored by other stockholders.

The fact that certain significant shareholders have additional shares registered for sale may depress market prices of our common stock — We have filed a registration statement with the SEC covering the potential sale by 1st Source Bank as trustee of the certain trusts established for the benefit of the extended families of two of the children of Ernestine Raclin. Approximately 1.9 million shares of our common stock remained registered for sale as of December 31, 2015, and may be sold after February 28, 2016, under the registration statement at the direction of the principal beneficiaries of the pertinent trusts and certain other selling shareholders. Such holders may choose to sell their remaining registered shares at any time. Some market participants may assume that such remaining shares will become available to the market relatively soon and choose to defer purchasing our shares on the market. This may, in turn have an effect of depressing the market price for our common stock. In addition, the future sale of substantial amounts of common stock by the holders of such registered shares may also depress the market price of our common stock.

Reputational Risks

Competition from other financial services providers could adversely impact our results of operations — The banking and financial services business is highly competitive. We face competition in making loans and leases, attracting deposits and providing insurance, investment, trust, and other financial services. Increased competition in the banking and financial services businesses may reduce our market share, impair our growth or cause the prices we charge for our services to decline. Our results of operations may be adversely impacted in future periods depending upon the level and nature of competition we encounter in our various market areas.

Managing reputational risk is important to attracting and maintaining customers, investors, and employees — Threats to our reputation can come from many sources, including adverse sentiment about financial institutions generally, unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, and questionable or fraudulent activities of our customers. We have policies and procedures in place that seek to protect our reputation and promote ethical conduct. Nonetheless, negative publicity may arise regarding our business, employees, or customers, with or without merit, and could result in the loss of customers, investors, or employees, costly litigation, a decline in revenues, and increased government regulation.

Table of Contents

Item 1B. Unresolved Staff Comments.
None
Item 2. Properties.
Our headquarters building is located in downtown South Bend, Indiana. The building is part of a larger complex, including a 300-room hotel and a 500-car parking garage. In December 2010, we entered into a new 10.5 year lease on our headquarters building which became effective January 1, 2011. As of December 31, 2015, 1st Source leases approximately 69% of the office space in this complex.
At December 31, 2015, we also owned property and/or buildings where 57 of 1st Source Bank’s 81 banking centers were located, including the facilities in Allen, Elkhart, Fulton, Huntington, Kosciusko, LaPorte, Marshall, Porter, Pulaski, St. Joseph, Starke, Tippecanoe, Wells, and Whitley Counties in the State of Indiana and Berrien, Cass, and Kalamazoo Counties in the State of Michigan, as well as an operations center and our former headquarters building, which is utilized for additional business operations. The Bank leases additional property and/or buildings to and from third parties under lease agreements negotiated at arms-length.
During 2015, we continued work on our banking center network by investing approximately $6 million which primarily related to the opening of three new banking centers and relocating two other ones in various markets. In 2014, we made an investment of approximately $8 million refurbishing six banking centers and opening three new ones in our Fort Wayne, Indiana region.
Item 3. Legal Proceedings.
As previously reported, 1st Source Bank, as the trustee (the “Trustee”) of the Morris Family Trusts for Ernestine M. Raclin, Chairman Emeritus of the Company, and other beneficiaries, requested approval of the Probate Court of St. Joseph County Indiana to divide the Morris Family Trusts into four separate family trust lines. The Trustee also sought other relief regarding the trusts including approving its accounts. The action was taken for financial and estate planning purposes, including the possible divesture of some 1st Source Corporation common stock owned by the Trusts. Shares at issue in the probate action held by the Morris Family Trusts represent approximately 21% of the outstanding common stock of the Company. 1st Source Bank has served as Trustee continuously since 1985. The four family trust lines correspond to the four children of Mrs. Raclin. (Mrs. Raclin's daughter, Carmen is the wife of Christopher J. Murphy III, the Chairman of the Board and Chief Executive Officer of the Company.) In a response filed on September 28, 2012, two of the siblings and their respective children filed a joint answer to the Trustee’s petition and a counter-petition setting forth their objection to the Trustee’s proposed division of the Morris Family Trusts into four family trust lines. They also sought affirmative relief, alleging that the Trustee breached its duties by, among other things, failing to diversify the assets in the Morris Family Trusts.

The parties reached a settlement of these proceedings, which was approved by the Court on October 8, 2015 and became effective on such date. Pursuant to the settlement agreement, the Morris Family Trusts were divided into the four separate family trust lines and the trusts were modified to allow representatives of the four respective family trust lines (if and when they so choose) to direct the trustee (or appoint a special trustee) to diversify the 1st Source stock holdings in such trusts. As part of the settlement, 1st Source Corporation agreed to cooperate with actions of the trustee to liquidate 1st Source shares at the respective and separate future directions of such family representatives that may be given from time to time. Such cooperation includes filing, and maintaining the effectiveness of, a “shelf” registration statement with the Securities and Exchange Commission covering such trust shares and shares held by members of the families within such family lines. Each family line representative may also separately direct the trustee to vote 1st Source shares in the trusts of such family line in accordance with the recommendations of a public proxy guidance service. If the family representative appoints a special trustee for shares in one or more trusts in such representative’s family group, the special trustee will have power to vote such shares. Pursuant to the settlement, 1st Source Bank agreed to afford a credit in respect of certain trustee fees associated with the trusts in the amount of $150,000 and 1st Source agreed to bear up to $400,000 of certain expenses associated with potential transactions in future periods to diversify 1st Source shares held in the Morris Family Trusts.

1st Source and our subsidiaries are involved in various other legal proceedings incidental to the conduct of our businesses. Our management does not expect that the outcome of any such proceedings will have a material adverse effect on our consolidated financial position or results of operations.

Item 4. Mine Safety Disclosures.

None

Part II

15

Table of Contents

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

Our common stock is traded on the NASDAQ Global Select Market under the symbol "SRCE." The following table sets forth for each quarter the high and low sales prices for our common stock, as reported by NASDAQ, and the cash dividends paid per share for each quarter.

	2015 Sales Price		Cash Dividends	2014 Sales Price		Cash Dividends
Common Stock Prices* (quarter ended)	High	Low	Paid	High	Low	Paid
March 31	$31.35	$26.95	$ 0.164	$29.64	$25.05	$ 0.155
June 30	31.75	27.69	0.164	30.19	26.15	0.164
September 30	32.37	28.06	0.164	29.02	25.27	0.164
December 31	34.35	29.35	0.180	32.02	25.45	0.164

*Share and per share figures have been adjusted for 10% stock dividend declared July 22, 2015 and issued on August 14, 2015.

As of February 12, 2016, there were 854 holders of record of 1st Source common stock.

Comparison of Five Year Cumulative Total Return*

Among 1st Source, Morningstar Market Weighted NASDAQ Index** and Peer Group Index***

* Assumes $100 invested on December 31, 2010, in 1st Source Corporation common stock, NASDAQ market index, and peer group index.

** The Morningstar Weighted NASDAQ Index Return is calculated using all companies which trade as NASD Capital Markets, NASD Global Markets or NASD Global Select. It includes both domestic and foreign companies. The index is weighted by the then current shares outstanding and assumes dividends reinvested. The return is calculated on a monthly basis.

*** The peer group is a market-capitalization-weighted stock index of 45 banking companies in Illinois, Indiana, Michigan, Ohio, and Wisconsin.

NOTE: Total return assumes reinvestment of dividends.

Table of Contents

The following table shows our share repurchase activity during the three months ended December 31, 2015.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	Maximum Number (or Approximate Dollar Value) of Shares that may yet be Purchased Under the Plans or Programs
October 01 - 31, 2015	6,167	$33.14	6,167	1,707,007
November 01 - 30, 2015	20,915	31.93	20,915	1,686,092
December 01 - 31, 2015	28,640	31.07	28,640	1,657,452

*1st Source maintains a stock repurchase plan that was authorized by the Board of Directors on July 24, 2014. Under the terms of the plan, 1st Source may repurchase up to 2,000,000** shares of its common stock from time to time to mitigate the potential dilutive effects of stock-based incentive plans and other potential uses of common stock for corporate purposes. Since the inception of the plan, 1st Source has repurchased a total of 342,548** shares.
**Unadjusted for 10% stock dividend declared July 22, 2015 and issued on August 14, 2015.

Federal laws and regulations contain restrictions on the ability of 1st Source and the Bank to pay dividends. For information regarding restrictions on dividends, see Part I, Item 1, Business - Regulation and Supervision - Dividends and Part II, Item 8, Financial Statements and Supplementary Data - Note 20 of the Notes to Consolidated Financial Statements.

Item 6. Selected Financial Data.

The following table shows selected financial data and should be read in conjunction with our Consolidated Financial Statements and the accompanying notes presented elsewhere herein.

(Dollars in thousands, except per share amounts)	2015	2014	2013	2012	2011
Interest income	$184,684	$178,554	$179,585	$182,085	$187,523
Interest expense	18,163	18,225	22,768	30,309	39,123
Net interest income	166,521	160,329	156,817	151,776	148,400
Provision for loan and lease losses	2,160	3,733	772	5,752	3,129
Net interest income after provision for loan and lease losses	164,361	156,596	156,045	146,024	145,271
Noninterest income	83,316	77,887	77,212	81,192	80,872
Noninterest expense	159,114	150,040	149,314	151,536	152,354
Income before income taxes	88,563	84,443	83,943	75,680	73,789
Income taxes	31,077	26,374	28,985	26,047	25,594
Net income	$57,486	$58,069	$54,958	$49,633	$48,195
Assets at year-end	$5,187,916	$4,829,958	$4,722,826	$4,550,693	$4,374,071
Long-term debt and mandatorily redeemable securities at year-end	57,379	56,232	58,335	71,021	37,156
Shareholders’ equity at year-end	644,053	614,473	585,378	558,655	523,918
Basic net income per common share*	2.17	2.17	2.03	1.83	1.78
Diluted net income per common share*	2.17	2.17	2.03	1.83	1.78
Cash dividends per common share*	0.671	0.645	0.618	0.600	0.582
Dividend payout ratio	30.85 %	29.71 %	30.49 %	32.67 %	32.65 %
Return on average assets	1.15 %	1.21 %	1.19 %	1.11 %	1.09 %
Return on average common shareholders' equity	9.05 %	9.65 %	9.55 %	9.10 %	9.51 %
Average common shareholders' equity to average assets	12.72 %	12.52 %	12.49 %	12.20 %	11.51 %

*Per share data gives retrospective effect to a 10% stock dividend declared on July 22, 2015 and issued on August 14, 2015.

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

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing our results of operations for each of the past three years and financial condition for each of the past two years. In order to fully appreciate this analysis the reader is encouraged to review the consolidated financial statements and statistical data presented in this document.

Table of Contents

FORWARD-LOOKING STATEMENTS

This report, including Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements. Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions, and future performance, and involve known and unknown risks, uncertainties and other factors, which may be beyond our control, and which may cause actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. Words such as "believe," "contemplate," "seek," "estimate," "plan," "project," "anticipate," "possible," "assume," "expect," "intend," "continue," "remain," "will," "should," "indicate," "would," "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements provide current expectations or forecasts of future events and are not guarantees of future performance, nor should they be relied upon as representing management's views as of any subsequent date.

All written or oral forward-looking statements that are made by or attributable to us are expressly qualified in their entirety by this cautionary notice. We have no obligation, and do not undertake, to update, revise, or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made. We have expressed our expectations, beliefs, and projections in good faith and we believe they have a reasonable basis. However, we make no assurances that our expectations, beliefs, or projections will be achieved or accomplished. The results or outcomes indicated by our forward-looking statements may not be realized due to a variety of factors, including, without limitation, the following:

- Local, regional, national, and international economic conditions and the impact they may have on us and our clients and our assessment of that impact.
- Changes in the level of nonperforming assets and charge-offs.
- Changes in estimates of future cash reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
- The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.
- Inflation, interest rate, securities market, and monetary fluctuations.
- Political instability.
- Acts of war or terrorism.
- Substantial changes in the cost of fuel.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by others.
- Changes in consumer spending, borrowings, and savings habits.
- Changes in the financial performance and/or condition of our borrowers.
- Technological changes.
- Acquisitions and integration of acquired businesses.
- The ability to increase market share and control expenses.
- The ability to expand effectively into new markets that we target.
- Changes in the competitive environment among bank holding companies.
- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities, and insurance) with which we and our subsidiaries must comply.
- The effect of changes in accounting policies and practices and auditing requirements, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standard setters.
- Changes in our organization, compensation, and benefit plans.
- The costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquires and the results of regulatory examinations or reviews.
- Greater than expected costs or difficulties related to the integration of new products and lines of business.

- Our success at managing the risks described in Item 1A. Risk Factors.

Table of Contents

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP) and follow general practices within the industries in which we operate. Application of these principles requires management to make estimates or judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates or judgments reflect management's view of the most appropriate manner in which to record and report our overall financial performance. Because these estimates or judgments are based on current circumstances, they may change over time or prove to be inaccurate based on actual experience. As such, changes in these estimates, judgments, and/or assumptions may have a significant impact on our financial statements. All accounting policies are important, and all policies described in Part II, Item 8, Financial Statements and Supplementary Data, Note 1 (Note 1), should be reviewed for a greater understanding of how our financial performance is recorded and reported.

We have identified the following three policies as being critical because they require management to make particularly difficult, subjective, and/or complex estimates or judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the determination of the reserve for loan and lease losses, fair value measurements, and the valuation of mortgage servicing rights. Management believes it has used the best information available to make the estimations or judgments necessary to value the related assets and liabilities. Actual performance that differs from estimates or judgments and future changes in the key variables could change future valuations and impact net income. Management has reviewed the application of these policies with the Audit Committee of the Board of Directors. Following is a discussion of the areas we view as our most critical accounting policies.

Reserve for Loan and Lease Losses — The reserve for loan and lease losses represents management's estimate of probable losses inherent in the loan and lease portfolio and the establishment of a reserve that is sufficient to absorb those losses. In determining an appropriate reserve, management makes numerous judgments, assumptions, and estimates based on continuous review of the loan and lease portfolio, estimates of client performance, collateral values, and disposition, as well as historical loss rates and expected cash flows. In assessing these factors, management benefits from a lengthy organizational history and experience with credit decisions and related outcomes. Nonetheless, if management's underlying assumptions prove to be inaccurate, the reserve for loan and lease losses would have to be adjusted. Our accounting policy related to the reserve is disclosed in Note 1 under the heading "Reserve for Loan and Lease Losses."

Fair Value Measurements — We use fair value measurements to record certain financial instruments and to determine fair value disclosures. Available-for-sale securities, trading account securities, mortgage loans held for sale, and interest rate swap agreements are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve write-downs of, or specific reserves against, individual assets. GAAP establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used in the measurement are observable or unobservable. Observable inputs reflect market-driven or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data. The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market data. For financial instruments that trade actively and have quoted market prices or observable market data, there is minimal subjectivity involved in measuring fair value. When observable market prices and data are not fully available, management judgment is necessary to estimate fair value. In addition, changes in the market conditions may reduce the availability of quoted prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. Therefore, when market data is not available, we use valuation techniques that require more management judgment to estimate the appropriate fair value measurement. Fair value is discussed further in Note 1 under the heading "Fair Value Measurements" and in Note 21, "Fair Value Measurements."

Mortgage Servicing Rights Valuation — We recognize as assets the rights to service mortgage loans for others, known as mortgage servicing rights (MSRs), whether the servicing rights are acquired through purchases or through originated loans. MSRs do not trade in an active open market with readily observable market prices. Although sales of MSRs do occur, the precise terms and conditions may not be readily available. As such, the value of MSRs is established and valued using discounted cash flow modeling techniques which require management to make estimates regarding future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors. The estimated rates of mortgage loan prepayments are the most significant factors driving the value of MSRs. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. In determining the fair value of the MSRs, mortgage interest rates (which are used to determine prepayment rates), and discount rates are held constant over the estimated life of the portfolio. Estimated mortgage loan prepayment rates are derived from a third-party model and adjusted to reflect our actual prepayment experience. MSRs are carried at the lower of amortized cost or fair value. The values of these assets are sensitive to changes in the assumptions used and readily available market pricing does not exist. The valuation of MSRs is discussed further in Note 21, “Fair Value Measurements.”

Table of Contents

EARNINGS SUMMARY

Net income in 2015 was $57.49 million, down from $58.07 million in 2014 and up from $54.96 million in 2013. Diluted net income per common share was $2.17 in 2015 and 2014, and $2.03 in 2013. Return on average total assets was 1.15% in 2015 compared to 1.21% in 2014, and 1.19% in 2013. Return on average common shareholders' equity was 9.05% in 2015 versus 9.65% in 2014, and 9.55% in 2013.

Net income in 2015, as compared to 2014, was positively impacted by a $6.19 million or 3.86% increase in net interest income and a $1.57 million or 42.14% decrease in provision for loan and lease losses and a $5.43 million or 6.97% increase in noninterest income, which was offset by $9.07 million or 6.05% increase in noninterest expense and a $4.70 million or 17.83% increase in in income tax expense. Net income in 2014 was positively impacted by a $3.51 million or 2.24% increase in net interest income and a $2.61 million or 9.01% decrease in income tax expense, which was offset by a $2.96 million or 383.55% increase in provision for loan and lease losses over 2013.

Dividends paid on common stock in 2015 amounted to $0.671 per share, compared to $0.645 per share in 2014, and $0.618 per share in 2013. The level of earnings reinvested and dividend payouts are determined by the Board of Directors based on management's assessment of future growth opportunities and the level of capital necessary to support them.

Net Interest Income — Our primary source of earnings is net interest income, the difference between income on earning assets and the cost of funds supporting those assets. Significant categories of earning assets are loans and securities while deposits and borrowings represent the major portion of interest-bearing liabilities. For purposes of the following discussion, comparison of net interest income is done on a tax equivalent basis, which provides a common basis for comparing yields on earning assets exempt from federal income taxes to those which are fully taxable.

Net interest margin (the ratio of net interest income to average earning assets) is significantly affected by movements in interest rates and changes in the mix of earning assets and the liabilities that fund those assets. Net interest margin on a fully taxable equivalent basis was 3.60% in 2015, compared to 3.59% in 2014 and 3.67% in 2013. Net interest income was $166.52 million for 2015, compared to $160.33 million for 2014 and $156.82 million for 2013. Tax-equivalent net interest income totaled $168.22 million for 2015, up $6.05 million from the $162.17 million reported in 2014. Tax-equivalent net interest income for 2014 was up $3.53 million from the $158.64 million reported for 2013.

During 2015, average earning assets increased $155.18 million while average interest-bearing liabilities increased $64.35 million over the comparable period in 2014. The yield on average earning assets decreased 1 basis point to 3.99% for 2015 from 4.00% for 2014 due to the reduction in loan and investment yields. Loan and lease net interest recoveries of $3.97 million in 2015, $1.59 million in 2014, and $3.88 million in 2013 helped offset continued pressure in the current interest rate environment. Total cost of average interest-bearing liabilities decreased 2 basis points to 0.52% during 2015 from 0.54% in 2014 as a result of the current low interest rate environment. The result was an increase of 1 basis point to net interest spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities.

The largest contributor to the decrease in the yield on average earning assets in 2015 was the 3 basis point decrease in the loan and lease portfolio yield. Average net loans and leases increased $197.16 million or 5.42% in 2015 from 2014 while the yield decreased to 4.39%.

During 2015, the tax-equivalent yield on securities available for sale decreased 10 basis points to 2.08% while the average balance decreased $35.04 million. Average mortgages held for sale decreased $0.04 million during 2015 and the yield decreased 19 basis points. Average other investments, which include federal funds sold, time deposits with other banks, Federal Reserve Bank excess balances, Federal Reserve Bank and Federal Home Loan Bank (FHLB) stock and commercial paper decreased $6.90 million during 2015 while the yield increased 46 basis points. The increase in yield was primarily a result of lower outstanding balances at higher rates.

Average interest-bearing deposits increased $91.30 million during 2015 while the effective rate paid on those deposits decreased 1 basis point. Average noninterest-bearing demand deposits increased $92.02 million during 2015.

Average short-term borrowings decreased $26.44 million during 2015 while the effective rate paid decreased 1 basis point. Average long-term debt decreased $0.51 million during 2015 as the effective rate decreased 21 basis points. The decrease in effective rate was primarily due to higher rates on mandatorily redeemable securities in 2014.

20

Table of Contents

The following table provides an analysis of net interest income and illustrates interest income earned and interest expense charged for each major component of interest earning assets and the interest bearing liabilities. Yields/rates are computed on a tax-equivalent basis, using a 35% rate. Nonaccrual loans and leases are included in the average loan and lease balance outstanding.

	2015			2014			2013		
(Dollars in thousands)	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate
ASSETS									
Investment securities:									
Taxable	$664,480	$11,929	1.80%	$694,830	$13,054	1.88%	$731,371	$14,414	1.97%
Tax-exempt	122,500	4,406	3.60	127,191	4,834	3.80	109,427	4,565	4.17
Mortgages held for sale	11,099	439	3.96	11,143	462	4.15	7,571	300	3.96
Net loans and leases	3,837,149	168,611	4.39	3,639,985	161,027	4.42	3,433,938	161,192	4.69
Other investments	33,583	997	2.97	40,482	1,016	2.51	43,600	940	2.16
Total earning assets	4,668,811	186,382	3.99	4,513,631	180,393	4.00	4,325,907	181,411	4.19
Cash and due from banks	61,400			62,263			58,762		
Reserve for loan and lease losses	(87,208)			(86,982)			(85,203)		
Other assets	351,205			317,893			308,483		
Total assets	$4,994,208			$4,806,805			$4,607,949		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest bearing deposits	$3,106,990	$11,489	0.37%	$3,015,693	$11,356	0.38%	$3,010,183	$16,604	0.55%
Short-term borrowings	236,940	484	0.20	263,377	541	0.21	154,804	211	0.14
Subordinated notes	58,764	4,220	7.18	58,764	4,220	7.18	58,764	4,220	7.18
Long-term debt and mandatorily redeemable securities	57,245	1,970	3.44	57,757	2,108	3.65	62,807	1,733	2.76
Total interest bearing liabilities	3,459,939	18,163	0.52	3,395,591	18,225	0.54	3,286,558	22,768	0.69
Noninterest bearing deposits	854,070			762,050			690,326		
Other liabilities	44,702			47,272			55,403		
Shareholders' equity	635,497			601,892			575,662		
Total liabilities and shareholders' equity	$4,994,208			$4,806,805			$4,607,949		
Net interest income		$168,219			$162,168			$158,643	
Net interest margin on a tax equivalent basis			3.60%			3.59%			3.67%

Table of Contents

The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each. The following table shows changes in tax equivalent interest earned and interest paid, resulting from changes in volume and changes in rates.

	Increase (Decrease) due to		
(Dollars in thousands)	Volume	Rate	Net
2015 compared to 2014			
Interest earned on:			
Investment securities:			
Taxable	$(558)	$(567)	$(1,125)
Tax-exempt	(173)	(255)	(428)
Mortgages held for sale	(2)	(21)	(23)
Net loans and leases	8,715	(1,131)	7,584
Other investments	(187)	168	(19)
Total earning assets	$7,795	$(1,806)	$5,989
Interest paid on:			
Interest bearing deposits	$342	$(209)	$133
Short-term borrowings	(54)	(3)	(57)
Subordinated notes	—	—	—
Long-term debt and mandatorily redeemable securities	(18)	(120)	(138)
Total interest bearing liabilities	$270	$(332)	$(62)
Net interest income	$7,525	$(1,474)	$6,051
2014 compared to 2013			
Interest earned on:			
Investment securities:			
Taxable	$(718)	$(642)	$(1,360)
Tax-exempt	594	(325)	269
Mortgages held for sale	147	15	162
Net loans and leases	9,385	(9,550)	(165)
Other investments	(58)	134	76
Total interest earning assets	$9,350	$(10,368)	$(1,018)
Interest paid on:			
Interest bearing deposits	$21	$(5,269)	$(5,248)
Short-term borrowings	190	140	330
Subordinated notes	—	—	—
Long-term debt and mandatorily redeemable securities	(124)	499	375
Total interest bearing liabilities	$87	$(4,630)	$(4,543)
Net interest income	$9,263	$(5,738)	$3,525

Noninterest Income — Noninterest income increased $5.43 million or 6.97% in 2015 from 2014 following a slight increase in 2014 over 2013. The following table shows noninterest income for the most recent three years ended December 31.

(Dollars in thousands)	2015	2014	2013
Noninterest income:			
Trust fees	$19,126	$18,511	$17,383
Service charges on deposit accounts	9,313	8,684	9,177
Debit card income	10,217	9,585	8,882
Mortgage banking income	4,570	5,381	5,944
Insurance commissions	5,465	5,556	5,492
Equipment rental income	22,302	17,156	16,229

Gains (losses) on investment securities available-for-sale	4	963	(168)
Other income	12,319	12,051	14,273
Total noninterest income	$83,316	$77,887	$77,212

22

Table of Contents

Trust fees (which include investment management fees, estate administration fees, mutual fund fees, annuity fees, and fiduciary fees) increased by $0.62 million or 3.32% in 2015 from 2014 compared to an increase of $1.13 million or 6.49% in 2014 over 2013. Trust fees are largely based on the size of client relationships and the market value of assets under management. The market value of trust assets under management at December 31, 2015 and 2014 was $3.78 billion and $3.95 billion, respectively. At December 31, 2015, these trust assets were comprised of $2.35 billion of personal and agency trusts and estate administration assets, $1.00 billion of employee benefit plan assets, $0.35 million of individual retirement accounts, and $0.08 million of custody assets.
Service charges on deposit accounts grew by $0.63 million or 7.24% in 2015 from 2014 compared to a decrease of $0.49 million or 5.37% in 2014 from 2013. The increase in service charges on deposit accounts in 2015 reflects an increase in statement fees and ATM fees due to a change in the fee structure that went into effect January 1, 2015 and higher nonsufficient fund transactions. The decrease in service charges on deposit accounts in 2014 was primarily due to lower volumes of nonsufficient fund transactions.
Debit card income improved $0.63 million or 6.59% in 2015 from 2014 compared to an increase of $0.70 million or 7.91% in 2014 from 2013. The increase in 2015 and 2014 was the result of an increased volume of debit card transactions.
Mortgage banking income declined $0.81 million or 15.07% in 2015 over 2014, compared to a decrease of $0.56 million or 9.47% in 2014 over 2013. We had no MSR impairment in 2015, 2014 or 2013. During 2015, 2014 and 2013, we determined that no permanent write-down was necessary for previously recorded impairment on MSRs. During 2015, mortgage banking income was negatively impacted by decreased gains on loan sales due to reduced profit margins and higher MSR amortization expense. During 2014, mortgage banking income was negatively impacted by decreased gains on loan sales due to reduced profit margins offset by lower MSR amortization expense and higher secondary market loan production volumes.
Insurance commissions decreased slightly in 2015 compared to 2014 and increased slightly in 2014 compared to 2013.
Equipment rental income generated from operating leases increased by $5.15 million or 30.00% during 2015 from 2014 compared to an increase of $0.93 million or 5.71% during 2014 from 2013. The average equipment rental portfolio increased 35.13% in 2015 over 2014 and 5.55% in 2014 over 2013 as the result of improving market conditions for equipment finance mainly in construction equipment, auto and light trucks and medium and heavy duty trucks. In 2015 and 2014 the increase in equipment rental income was offset by a similar increase in depreciation on equipment owned under operating leases.
Sales of investment securities available-for-sale resulted in gains of $4,000 for the year ended 2015 compared to gains of $0.96 million for the year ended 2014 and losses of $0.17 million for the year ended 2013. During 2015, gains were the result of sales of U.S. States and political subdivisions securities. The gains in 2014 were the result of a sale of a marketable equity security. The loss in 2013 related to an investment portfolio loss on an adjustable rate security.
Other income increased $0.27 million or 2.22% in 2015 from 2014 compared to a decrease of $2.22 million or 15.57% in 2014 from 2013. The increase in 2015 was mainly the result of lower losses on partnership investments, higher customer swap fees and claim proceeds from bank owned life insurance offset by lower monogram fund income and a one-time valuation adjustment in 2014. The decrease in 2014 was mainly the result of losses on partnership investments, lower monogram fund income, dividend income and customer swap fees offset by higher mutual fund income.
Noninterest Expense — Noninterest expense increased $9.07 million or 6.05% in 2015 over 2014 following a slight increase in 2014 from 2013. The following table shows Noninterest expense for the recent three years ended December 31.

(Dollars in thousands)	2015	2014	2013
Noninterest expense:			
Salaries and employee benefits	$86,133	$80,488	$79,783
Net occupancy expense	9,768	9,311	8,700
Furniture and equipment expense	18,348	17,657	16,895
Depreciation — leased equipment	18,280	13,893	13,055
Professional fees	4,682	5,046	5,321

Supplies and communications	6,011	5,589	5,690
FDIC and other insurance	3,412	3,384	3,462
Business development and marketing expense	4,837	6,049	4,938
Loan and lease collection and repossession expense	667	1,102	4,030
Other expense	6,976	7,521	7,440
Total noninterest expense	$159,114	$150,040	$149,314

Total salaries and employee benefits increased $5.65 million or 7.01% in 2015 from 2014, following a $0.71 million or 0.88% increase in 2014 from 2013.

Table of Contents

Employee salaries increased $4.32 million or 6.70% in 2015 from 2014 compared to an increase of $0.53 million of 0.83% in 2014 from 2013. The increase in 2015 was a result of higher base salaries, producer commissions and executive incentives. Higher base salary expense was primarily due to more full-time equivalent employees as a result of opening three new banking centers in 2014 and one new banking center in 2015, filling other open positions and normal performance raises. Producer commissions increased primarily in the areas of insurance and trust due to new client relationships. The increase in 2014 was a result of higher base salaries offset by lower producer commissions. Higher base salary expense was primarily due to more full time equivalent employees as a result of opening three new banking centers and increases from the annual performance raises. Producer commissions were lower due to decreased residential mortgage loan production volumes.

Employee benefits increased $1.33 million or 8.28% in 2015 from 2014, compared to a slight increase in 2014 from 2013. During 2015, group insurance costs increased as a result of higher claims experience including the removal of lifetime caps and other various items under the Affordable Care Act.

Occupancy expense increased $0.46 million or 4.91% in 2015 from 2014, compared to an increase of $0.61 million or 7.02% in 2014 from 2013. The higher expense in 2015 was mainly due to increased real estate taxes as a result of assessments on new banking centers and remodeling to existing banking centers, real estate tax appeal settlements received in 2014 and increased premises repairs. The higher expense in 2014 was mainly due to higher snow removal services and real estate taxes..

Furniture and equipment expense, including depreciation, grew by $0.69 million or 3.91% in 2015 from 2014 compared to an increase of $0.76 million or 4.51% in 2014 from 2013. The higher expense during 2015 was primarily due to increased software and equipment maintenance costs, computer processing charges and equipment repairs. The higher expense in 2014 was in the areas of computer processing charges and equipment repair. Additionally, in 2014 purchases of furniture and equipment increased due to renovations of six existing banking centers and the opening of three new banking centers.

Depreciation on equipment owned under operating leases increased $4.39 million or 31.58% in 2015 from 2014, following a $0.84 million or 6.42% increase in 2014 from 2013. In 2015 and 2014, depreciation on equipment owned under operating leases changed in conjunction with the increase in equipment rental income.

Professional fees declined $0.36 million or 7.21% in 2015 from 2014, compared to a $0.28 million or 5.17% decrease in 2014 from 2013. The decrease in 2015 was primarily due to lower audit fees and the reduced utilization of consulting services offset by higher director fees. The decrease in 2014 was primarily due to the reduced utilization of consulting services.

Supplies and communications expense increased $0.42 million or 7.55% in 2015 from 2014, and decreased slightly in 2014 from 2013. The increase in 2015 was mainly the result of replacing debit cards with the new embedded EMV chip.

FDIC and other insurance expense was flat in 2015 from 2014 and flat in 2014 from 2013.

Business development and marketing expenses were reduced by $1.21 million or 20.04% in 2015 from 2014 compared to a $1.11 million or 22.50% increase in 2014 from 2013. The lower expense in 2015 was primarily the result of decreased charitable contributions offset by increased marketing promotions. The higher expense in 2014 was the result of increased charitable contributions and increased retail marketing.

Loan and lease collection and repossession expenses decreased $0.44 million or 39.47% in 2015 from 2014 compared to a decrease of $2.93 million or 72.66% in 2014 from 2013. Loan and lease collection and repossession expense was lower in 2015 mainly due to a decrease in collection and repossession expenses and lower repurchased mortgage loan losses as a result of fewer loan repurchase requests offset by increased valuation adjustments and fewer gains on the sale of other real estate and repossessions. The decrease in 2014 was mainly due to reduced repurchased mortgage loan losses as a result of fewer loan repurchase requests and gains on the sale of other real estate and repossessions.

Other expenses declined $0.55 million or 7.25% in 2015 as compared to 2014 and were flat in 2014 as compared to 2013. The decrease in 2015 was mainly due to lower expenses related to a previously reported proceeding that involved the Bank as trustee, reduced intangible asset amortization as items fully amortize and fewer writedowns on a property held for sale offset by higher mortgage servicing foreclosure expenses, provision on unfunded loan commitments, employment and relocation expenses and increased debit card losses.

Income Taxes — 1st Source recognized income tax expense in 2015 of $31.08 million, compared to $26.37 million in 2014, and $28.99 million in 2013. The effective tax rate in 2015 was 35.09% compared to 31.23% in 2014, and 34.53% in 2013. The provision for income taxes included a one-time benefit of $3.30 million for the twelve months ended December 31, 2014 which resulted in a lower effective tax rate for 2014 compared to 2015 and 2013. These benefits were the result of a reduction in uncertain tax positions due to settlements with taxing authorities and the lapse of the applicable statute of limitations.

Table of Contents

Effective January 1, 2014, the Indiana Financial Institutions Tax (FIT) rate decreased from 8.5% to 8.0% and will continue to decrease by 0.5% each of the next three years. As a result of the change, we decreased the carrying value of certain state deferred tax assets. The impact of the change was not material and was recorded in the financial statements during the second quarter of 2013. Additionally, on March 25, 2014, FIT tax rate decreases from 6.5% in 2018 to 4.9% in 2023 were enacted. These further decreases did not have an impact on our deferred taxes and as a result, no amount was recorded in our financial statements for this rate change. For a detailed analysis of 1st Source's income taxes see Part II, Item 8, Financial Statements and Supplementary Data — Note 17 of the Notes to Consolidated Financial Statements.

FINANCIAL CONDITION

Loan and Lease Portfolio — The following table shows 1st Source's loan and lease distribution at the end of each of the last five years as of December 31.

(Dollars in thousands)	2015	2014	2013	2012	2011
Commercial and agricultural	$744,749	$710,758	$679,492	$639,069	$545,570
Auto and light truck	425,236	397,902	391,649	396,602	378,604
Medium and heavy duty truck	278,254	247,153	237,854	213,547	217,157
Aircraft financing	778,012	727,665	738,133	696,479	620,782
Construction equipment financing	455,565	399,940	333,088	278,974	261,204
Commercial real estate	700,268	616,587	583,997	554,968	545,457
Residential real estate	464,129	445,759	460,981	438,641	423,606
Consumer	148,479	142,810	124,130	109,273	98,163
Total loans and leases	$3,994,692	$3,688,574	$3,549,324	$3,327,553	$3,090,543

At December 31, 2015, there were no concentrations within the loan portfolio of 10% or more of total loans and leases.

Loans and leases, net of unearned discount, at December 31, 2015, were $3.99 billion and were 77.00% of total assets, compared to $3.69 billion and 76.37% of total assets at December 31, 2014. Average loans and leases, net of unearned discount, increased $197.16 million or 5.42% and increased $206.05 million or 6.00% in 2015 and 2014, respectively.

Commercial and agricultural lending, excluding those loans secured by real estate, increased $33.99 million or 4.78% in 2015 over 2014. Commercial and agricultural lending outstandings were $744.75 million and $710.76 million at December 31, 2015 and December 31, 2014, respectively. This increase was mainly attributed to an improved economy in our target markets, resulting in greater line of credit usage and the financing of increased capital expenditures by our clients. In 2015, we continued to grow our business client base.

Auto and light truck loans increased $27.33 million or 6.87% in 2015 over 2014. At December 31, 2015, auto and light truck loans had outstandings of $425.24 million and $397.90 million at December 31, 2014. This increase was primarily attributable to the expansion of financing with many existing clients and an increase in client base offset by client consolidations during the year.

Medium and heavy duty truck loans and leases grew by $31.10 million or 12.58% in 2015. Medium and heavy duty truck financing at December 31, 2015 and 2014 had outstandings of $278.25 million and $247.15 million, respectively. Most of the increase at December 31, 2015 from December 31, 2014 can be attributed to clients replacing aged equipment.

Aircraft financing at year-end 2015 increased $50.35 million or 6.92% from year-end 2014. Aircraft financing at December 31, 2015 and 2014 had outstandings of $778.01 million and $727.67 million, respectively. The increase during 2015 was mainly due to growth in short-term dealer floor plans and a large helicopter syndication.

Construction equipment financing increased $55.63 million or 13.91% in 2015 compared to 2014. Construction equipment financing at December 31, 2015 had outstandings of $455.57 million, compared to outstandings of $399.94 million at December 31, 2014. The increase in this category was primarily due to a continued gradual improvement in the construction industry and the need to replace older equipment in addition to increases in equipment rental.

Commercial loans secured by real estate, of which approximately 50% is owner occupied, increased $83.68 million or 13.57% in 2015 over 2014. Commercial loans secured by real estate outstanding at December 31, 2015 were $700.27 million and $616.59 million at December 31, 2014. The increase was mainly due to general improvements in the business economy within our markets.

Residential real estate loans were $464.13 million at December 31, 2015 and $445.76 million at December 31, 2014. Residential real estate loans increased $18.37 million or 4.12% in 2015 from 2014. The increase in residential real estate loans was primarily due to higher demand for home equity lines of credit.

Table of Contents

Consumer loans increased $5.67 million or 3.97% in 2015 over 2014. Consumer loans outstanding at December 31, 2015, were $148.48 million and $142.81 million at December 31, 2014. The increase during 2015 was due to higher demand in auto, personal loans and other personal line of credit loans as a result of favorable interest rates.

The following table shows the maturities of loans and leases in the categories of commercial and agricultural, auto and light truck, medium and heavy duty truck, aircraft and construction equipment outstanding as of December 31, 2015.

(Dollars in thousands)	0-1 Year	1-5 Years	Over 5 Years	Total
Commercial and agricultural	$361,435	$342,121	$41,193	$744,749
Auto and light truck	180,463	242,756	2,017	425,236
Medium and heavy duty truck	87,258	186,200	4,796	278,254
Aircraft financing	200,031	496,569	81,412	778,012
Construction equipment financing	125,736	305,968	23,861	455,565
Total	$954,923	$1,573,614	$153,279	$2,681,816

The following table shows amounts due after one year are also classified according to the sensitivity to changes in interest rates.

Rate Sensitivity (Dollars in thousands)	Fixed Rate	Variable Rate	Total
1 – 5 Years	$1,021,358	$552,256	$1,573,614
Over 5 Years	34,421	118,858	153,279
Total	$1,055,779	$671,114	$1,726,893

During 2015, approximately 66% of the Bank’s residential mortgage originations were sold into the secondary market. Mortgage loans held for sale were $9.83 million at December 31, 2015 and were $13.60 million at December 31, 2014. Although 1st Source Bank is participating in the U.S. Treasury Making Home Affordable programs, we do not feel it has a material effect on our financial condition or results of operations.

1st Source Bank sells residential mortgage loans to Fannie Mae as well as FHA-insured and VA-guaranteed loans in Ginnie Mae mortgage-backed securities. Additionally, we have sold loans on a service released basis to various other financial institutions in recent years. The agreements under which we sell these mortgage loans contain various representations and warranties regarding the acceptability of loans for purchase. On occasion, we may be asked to indemnify the loan purchaser for credit losses on loans that were later deemed ineligible for purchase or we may be asked to repurchase a loan. Both circumstances are collectively referred to as “repurchases.” Within the industry, repurchase demands had been increasing during prior years but did slow during 2014 and continued to decrease in 2015. While we believe the loans we have underwritten and sold to these entities have met or exceeded applicable transaction parameters, we must acknowledge the trend of mortgage insurance rescissions and speculative repurchase requests. Our exposure risk for repurchases starts to reduce in 2016 as a result of the enhancements made by FNMA in 2013 to the selling representations and warranties framework as warranties on loans sold after implementation of such changes lapse.

Our liability for repurchases, included in Accrued Expenses and Other Liabilities on the Statements of Financial Condition, was $0.98 million and $1.72 million as of December 31, 2015 and 2014, respectively. Our expense (recovery) for repurchase losses, included in Loan and Lease Collection and Repossession expense on the Statements of Income, was $(0.75) million in 2015 compared to $(0.27) million in 2014 and $1.99 million in 2013. The mortgage repurchase liability represents our best estimate of the loss that we may incur. The estimate is based on specific loan repurchase requests and a historical loss ratio with respect to origination dollar volume. Because the level of mortgage loan repurchase losses is dependent on economic factors, investor demand strategies and other external conditions that may change over the life of the underlying loans, the level of liability for mortgage loan repurchase losses is difficult to estimate and requires considerable management judgment.

CREDIT EXPERIENCE

Reserve for Loan and Lease Losses — Our reserve for loan and lease losses is provided for by direct charges to operations. Losses on loans and leases are charged against the reserve and likewise, recoveries during the period for prior losses are credited to the reserve. Our management evaluates the reserve quarterly, reviewing all loans and leases over a fixed-dollar amount ($100,000) where the internal credit quality grade is at or below a predetermined classification, actual and anticipated loss experience, current economic events in specific industries, and other pertinent factors including general economic conditions. Determination of the reserve is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows or fair value of collateral on collateral-dependent impaired loans and leases, estimated losses on pools of homogeneous loans and leases based on historical loss experience, and consideration of environmental factors, principally economic risk and concentration risk, all of which may be susceptible to significant and unforeseen changes. We review the status of the loan and lease portfolio to identify borrowers that might develop financial problems in order to aid borrowers in the handling of their accounts and to mitigate losses. See Part II, Item 8, Financial Statements and Supplementary Data — Note 1 of the Notes to Consolidated Financial Statements for additional information on management's evaluation of the 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 we update our historical charge-off analysis, we review the look-back periods for each business loan portfolio.

During 2015, the medium-term portion of the look-back period was seven years given that 2009 through 2015 losses were considerably impacted by the severe recession. Although the recession began in December 2007, its financial consequences were not recognized in the loan portfolios until 2009. We gave the greatest weight to this recent seven year period in our calculation, as we feel it is most consistent with our current expectations for 2016. Furthermore, we perform a thorough analysis of charge-offs, non-performing asset levels, special attention outstandings and delinquency 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. We adjust the calculated historical based ratio as a result of our analysis of environmental factors, principally economic risk and concentration risk. Key economic factors affecting our 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 our business banking and commercial real estate portfolios and by collateral concentration in our specialty finance portfolios.

Weaknesses negatively impacting the U.S. recovery, are geopolitical events. Current concerns include the unrelenting decline in oil prices, the continued slowdown in China, the weak EU economies, the recessionary pressures in Japan and Brazil (with the resultant decline in value of the real), the geopolitical threats to the Russian economy as well as the economic decline due to Russia’s significant dependence on oil, and the heightened concerns of terrorist attacks. We include a factor in our loss ratios for global risk, as we are increasingly aware of the threat that global concerns may affect our customers. While we are unable to determine with any precision the impact of global economic and political issues on 1st Source Bank’s loan portfolios, we feel the risks are real and significant. We believe there is a risk of negative consequences for our borrowers that would affect their ability to repay their financial obligations. Therefore, we continue to include a factor for global risk in our analysis for 2015.

Another area of concern continues to be our aircraft portfolio where we have collateral concentration and $200 million foreign exposure. The aircraft industry was among the sectors affected most by the sluggish economy. We have seen some evidence that depressed private jet markets have stabilized. As the U.S. economy slowly improves, the industry is likely to benefit and we should see a decrease in the fleet of unsold pre-owned aircraft which will result in further strengthening of values. Nevertheless, we remain concerned about the prolonged low prices for several models. We also have foreign exposure in this portfolio, particularly in Mexico and Brazil. The recession in Brazil and the currency fluctuations are having a negative impact on our clients’ cost of paying dollar denominated debts and, as a result, we have experienced delinquency in this portfolio and we continue to experience higher default rates in this portfolio than in our other lending segments. We reassessed our ratios, which were established based on the higher and more volatile loss histories and, notwithstanding more recent currency fluctuation, made a modest adjustment to our reserve ratio for our aircraft portfolio which we believe to be appropriate given our disciplined loan underwriting practices.

We experienced ongoing improvement in the medium and heavy duty truck portfolio. We recognized sizable losses during 2009 and the first half of 2010; however, since then we have had no charge-offs. Our credit quality is strongest when industry conditions are favorable. Lower gas prices and growth in GDP, and the construction sector, which leads to higher demand for trucking bode well for the industry. Industry concerns include a persistent driver shortage, meeting emissions standards and achieving regulatory compliance. Nevertheless, the underlying industry fundamentals are expected to remain relatively stable. As a result, we maintained our risk factors at levels consistent with last year.

Our construction equipment portfolio is characterized by increasing outstanding loan balances and continued strong credit quality in 2015. The construction industry, which was hard hit during the recession, is benefiting from an improving economy, buoyed by growth in private residential and non-residential construction. The Bank has limited exposure to the industry's weakest sector, energy, which continues to struggle as a result of ongoing declines in oil and gas prices. Historically, 1st Source has experienced less volatility in this portfolio than the industry as losses have been mitigated by appropriate underwriting and a global market for used construction equipment. Weak global demand and the strong dollar held down used equipment exports, but the U.S. market remains solid. The underlying risk has not changed significantly for this portfolio; our reserve factors are similar to last year.

The auto and light truck portfolio outstanding loan balances remained relatively stable for the past three years, with normal seasonal fluctuations. Used cars held their values in 2015. Industry growth is projected to be accompanied by increasing rental rates, although we anticipate some dampening in the used auto market in 2016. We made a slight downward adjustment to the reserve ratio for the auto portfolio.

Table of Contents

There are several industries represented in the commercial and agricultural portfolio. The outlook for the business banking portfolio is guardedly optimistic. While recent economic news indicates modest improvement, exemplified by lower unemployment and increased consumer and small business confidence, the overall declines in the manufacturing sector are concerning. Furthermore, the decline in commodities prices, particularly corn and soybeans, will negatively impact the crop sector of our agriculture portfolio. We anticipate some of our borrowers will be unable to repay their lines of credit in full, resulting in carry-over debt. Overall, we are experiencing trends of generally improving credit quality, with low delinquencies and charge-offs. We have reviewed the calculated loss ratios and the environmental factors and concentration issues affecting these portfolios and incorporated minor adjustments to the reserve ratios as deemed appropriate.

Similar to the commercial portfolio, our commercial real estate loans are concentrated in our local market with local customers, with approximately fifty percent of the Bank's exposure being owner occupied facilities where we are the primary relationship bank for our customers. Nevertheless, we were not immune to the dramatic declines in real estate values following the great recession, similar to other U.S. markets and we experienced losses from 2009 through 2011. Furthermore, our recent portfolio growth has been in the more risky non-owner occupied sector. Our recent loss history is favorable; however, as a result of our growth in more risky sectors, we remain cautious and made only a modest adjustment to the reserve ratio.

The reserve for loan and lease losses at December 31, 2015, totaled $88.11 million and was 2.21% of loans and leases, compared to $85.07 million or 2.31% of loans and leases at December 31, 2014 and $83.51 million or 2.35% of loans and leases at December 31, 2013. It is our opinion that the reserve for loan and lease losses was appropriate to absorb probable losses inherent in the loan and lease portfolio as of December 31, 2015.

Charge-offs for loan and lease losses were $4.71 million for 2015, compared to $6.03 million for 2014 and $3.83 million for 2013. We had only one sizable charge-off in 2015 and it was on a commercial relationship. The provision for loan and lease losses was $2.16 million for 2015, compared to $3.73 million for 2014 and $0.77 million for 2013.

Table of Contents

The following table summarizes our loan and lease loss experience for each of the last five years ended December 31.

(Dollars in thousands)	2015	2014	2013	2012	2011
Amounts of loans and leases outstanding at end of period	$3,994,692	$3,688,574	$3,549,324	$3,327,553	$3,090,543
Average amount of net loans and leases outstanding during period	$3,837,149	$3,639,985	$3,433,938	$3,209,490	$3,078,581
Balance of reserve for loan and lease losses at beginning of period	$85,068	$83,505	$83,311	$81,644	$86,874
Charge-offs:					
Commercial and agricultural	3,489	5,007	538	524	1,667
Auto and light truck	24	42	226	3,754	105
Medium and heavy duty truck	—	—	57	41	241
Aircraft financing	244	—	1,308	600	4,681
Construction equipment financing	—	4	88	120	853
Commercial real estate	—	99	170	471	3,120
Residential real estate	141	46	316	594	282
Consumer	812	833	1,125	1,532	1,640
Total charge-offs	4,710	6,031	3,828	7,636	12,589
Recoveries:					
Commercial and agricultural	851	929	468	484	1,923
Auto and light truck	380	1,283	139	230	133
Medium and heavy duty truck	28	142	462	1,185	44
Aircraft financing	802	240	884	711	964
Construction equipment financing	434	525	323	268	308
Commercial real estate	2,807	347	627	223	346
Residential real estate	11	97	14	43	56
Consumer	281	298	333	407	456
Total recoveries	5,594	3,861	3,250	3,551	4,230
Net (recoveries) charge-offs	(884)	2,170	578	4,085	8,359
Provision for loan and lease losses	2,160	3,733	772	5,752	3,129
Balance at end of period	$88,112	$85,068	$83,505	$83,311	$81,644
Ratio of net (recoveries) charge-offs to average net loans and leases outstanding	(0.02)%	0.06%	0.02%	0.13%	0.27%
Ratio of reserve for loan and lease losses to net loans and leases outstanding end of period	2.21%	2.31%	2.35%	2.50%	2.64%
Coverage ratio of reserve for loan and lease losses to nonperforming loans and leases	686.23%	239.07%	225.73%	226.03%	143.49%

The following table shows net (recoveries) charge-offs as a percentage of average loans and leases by portfolio type:

	2015	2014	2013	2012	2011
Commercial and agricultural	0.36%	0.58%	0.01%	0.01%	(0.05)%
Auto and light truck	(0.08)	(0.30)	0.02	0.85	(0.01)
Medium and heavy duty truck	(0.01)	(0.06)	(0.19)	(0.53)	0.09
Aircraft financing	(0.07)	(0.03)	0.06	(0.02)	0.61
Construction equipment financing	(0.10)	(0.14)	(0.08)	(0.05)	0.20
Commercial real estate	(0.44)	(0.04)	(0.08)	0.05	0.49
Residential real estate	0.03	(0.01)	0.07	0.13	0.06
Consumer	0.36	0.41	0.67	1.08	1.24

Total net (recoveries) charge-offs to average portfolio loans and leases	(0.02)%	0.06%	0.02%	0.13%	0.27%

29

Table of Contents

The reserve for loan and lease losses has been allocated according to the amount deemed necessary to provide for the estimated probable losses that have been incurred within the categories of loans and leases set forth in the table below. The following table shows the amount of such components of the reserve at December 31 and the ratio of such loan and lease categories to total outstanding loan and lease balances.

	2015		2014		2013		2012		2011	
(Dollars in thousands)	Reserve Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases	Reserve Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases	Reserve Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases	Reserve Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases	Reserve Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases
Commercial and agricultural	$15,456	18.64 %	$11,760	19.27 %	$11,515	19.14 %	$12,326	19.21 %	$13,091	17.65 %
Auto and light truck	9,269	10.64	10,326	10.79	9,657	11.04	8,864	11.92	7,037	12.25
Medium and heavy duty truck	4,699	6.97	4,500	6.70	4,212	6.70	3,721	6.42	5,174	7.03
Aircraft financing	32,373	19.48	32,234	19.73	34,037	20.80	34,205	20.93	28,626	20.09
Construction equipment financing	7,592	11.40	7,008	10.84	5,972	9.38	5,390	8.38	6,295	8.45
Commercial real estate	13,762	17.53	13,270	16.72	12,406	16.45	13,778	16.68	16,772	17.65
Residential real estate	3,382	11.62	4,102	12.08	4,093	12.99	3,652	13.18	3,362	13.70
Consumer	1,579	3.72	1,868	3.87	1,613	3.50	1,375	3.28	1,287	3.18
Total	$88,112	100.00%	$85,068	100.00%	$83,505	100.00%	$83,311	100.00%	$81,644	100.00%

Nonperforming Assets — Nonperforming assets include loans past due over 90 days, nonaccrual loans, other real estate, repossessions and other nonperforming assets we own. Our policy is to discontinue the accrual of interest on loans and leases where principal or interest is past due and remains unpaid for 90 days or more, 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, which are placed on nonaccrual at the time the loan is placed in foreclosure and consumer loans that are both well secured and in the process of collection.

Nonperforming assets amounted to $20.62 million at December 31, 2015, compared to $42.48 million at December 31, 2014, and $46.75 million at December 31, 2013. During 2015, interest income on nonaccrual loans and leases would have increased by approximately $1.03 million compared to $3.03 million in 2014 if these loans and leases had earned interest at their full contractual rate.

Nonperforming assets at December 31, 2015 decreased from December 31, 2014, mainly due to decreases in nonaccrual loans and leases. The decrease in nonaccrual loans and leases occurred primarily in the commercial and agricultural, aircraft, and commercial real estate portfolios.

Table of Contents

Nonperforming assets at December 31 (Dollars in thousands)	2015	2014	2013	2012	2011
Loans past due over 90 days	$122	$981	$287	$442	$460
Nonaccrual loans and leases:					
Commercial and agricultural	4,283	14,284	11,765	9,179	10,966
Auto and light truck	46	38	3,511	35	193
Medium and heavy duty truck	—	56	188	875	3,408
Aircraft financing	4,388	12,473	10,365	5,292	12,526
Construction equipment financing	539	751	1,032	5,285	4,137
Commercial real estate	1,392	4,807	7,064	13,055	20,569
Residential real estate	1,822	1,968	2,399	2,323	4,380
Consumer	248	225	383	373	261
Total nonaccrual loans and leases	12,718	34,602	36,707	36,417	56,440
Total nonperforming loans and leases	12,840	35,583	36,994	36,859	56,900
Other real estate	736	1,109	4,539	7,311	7,621
Former bank premises held for sale	—	626	951	1,034	1,134
Repossessions:					
Commercial and agricultural	—	—	23	—	33
Auto and light truck	10	25	145	52	222
Medium and heavy duty truck	—	—	—	—	—
Aircraft financing	6,916	5,123	4,082	—	6,490
Construction equipment financing	—	—	—	—	—
Consumer	1	8	12	11	47
Total repossessions	6,927	5,156	4,262	63	6,792
Operating leases	121	6	—	—	29
Total nonperforming assets	$20,624	$42,480	$46,746	$45,267	$72,476
Nonperforming loans and leases to loans and leases, net of unearned discount	0.32 %	0.96 %	1.04 %	1.11 %	1.84 %
Nonperforming assets to loans and leases and operating leases, net of unearned discount	0.50 %	1.13 %	1.29 %	1.25 %	2.28 %

Potential Problem Loans — Potential problem loans consist of loans that are performing but for which management has concerns about the ability of a borrower to continue to comply with repayment terms because of the borrower's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. As of December 31, 2015 and 2014, we had $1.03 million and $16.18 million, respectively, in loans of this type which are not included in either of the non-accrual or 90 days past due loan categories. At December 31, 2015, potential problem loans consisted of one construction equipment credit relationship. Weakness in this company's operating performance and payment patterns has caused us to heighten attention given to this credit.

Foreign Outstandings — Our foreign loan and lease outstandings, all denominated in U.S. dollars were $205.83 million and $224.51 million as of December 31, 2015 and 2014, respectively. Foreign loans and leases are in aircraft financing. Loan and lease outstandings to borrowers in Brazil and Mexico were $76.79 million and $116.73 million as of December 31, 2015, respectively, compared to $105.39 million and $100.76 million as of December 31, 2014, respectively. Outstanding balances to borrowers in other countries were insignificant.

INVESTMENT PORTFOLIO

The amortized cost of securities at year-end 2015 increased slightly from 2014, following a decrease from year-end 2013 to year-end 2014. The amortized cost of securities at December 31, 2015 was $781.23 million or 15.06% of total assets, compared to $776.06 million or 16.07% of total assets at December 31, 2014.

Table of Contents

The following table shows the amortized cost of securities available-for-sale as of December 31.

(Dollars in thousands)	2015	2014	2013
U.S. Treasury and Federal agencies securities	$389,457	$371,878	$394,558
U.S. States and political subdivisions securities	120,441	121,510	120,416
Mortgage-backed securities — Federal agencies	234,400	248,299	273,495
Corporate debt securities	34,241	31,677	30,828
Foreign government and other securities	800	800	700
Marketable equity securities	1,893	1,893	2,166
Total investment securities available-for-sale	$781,232	$776,057	$822,163

Yields on tax-exempt obligations are calculated on a fully tax equivalent basis assuming a 35% tax rate. The following table shows the maturities of securities available-for-sale at December 31, 2015, at the amortized costs and weighted average yields of such securities.

(Dollars in thousands)	Amount	Yield	
U.S. Treasury and Federal agencies securities			
Under 1 year	$63,841	2.00	%
1 – 5 years	325,616	1.45	
5 – 10 years	—	—	
Over 10 years	—	—	
Total U.S. Treasury and Federal agencies securities	389,457	1.54	
U.S. States and political subdivisions securities			
Under 1 year	14,792	3.86	
1 – 5 years	86,967	3.45	
5 – 10 years	18,682	3.16	
Over 10 years	—	—	
Total U.S. States and political subdivisions securities	120,441	3.46	
Corporate debt securities			
Under 1 year	5,002	0.87	
1 – 5 years	29,239	1.87	
5 – 10 years	—	—	
Over 10 years	—	—	
Total Corporate debt securities	34,241	1.72	
Foreign government and other securities			
Under 1 year	—	—	
1 – 5 years	800	1.95	
5 – 10 years	—	—	
Over 10 years	—	—	
Total Foreign government and other securities	800	1.95	
Mortgage-backed securities — Federal agencies	234,400	2.39	
Marketable equity securities	1,893	7.65	
Total investment securities available-for-sale	$781,232	2.11	%

At December 31, 2015, the residential mortgage-backed securities we held consisted of GNMA, FNMA and FHLMC pass-through certificates (Government Sponsored Enterprise, GSEs). The type of loans underlying the securities were all conforming loans at the time of issuance. The underlying GSEs backing these mortgage-backed securities are rated Aaa or AA+ from the rating agencies. At December 31, 2015, the vintage of the underlying loans comprising our securities are: 23% in the years 2014 and 2015; 39% in the years 2012 and 2013; 19% in the years 2010 and 2011; and 19% in years 2009 and prior.

Table of Contents

DEPOSITS

The following table shows the average daily amounts of deposits and rates paid on such deposits.

	2015		2014		2013	
(Dollars in thousands)	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest bearing demand	$854,070	— %	$762,050	— %	$690,326	— %
Interest bearing demand	1,334,850	0.12	1,296,929	0.12	1,234,145	0.13
Savings	733,848	0.08	710,216	0.08	691,942	0.09
Time	1,038,292	0.89	1,008,548	0.91	1,084,096	1.33
Total deposits	$3,961,060		$3,777,743		$3,700,509	

See Part II, Item 8, Financial Statements and Supplementary Data — Note 10 of the Notes to Consolidated Financial Statements for additional information on deposits.

SHORT-TERM BORROWINGS

The following table shows the distribution of our short-term borrowings and the weighted average interest rates thereon at the end of each of the last three years. Also provided are the maximum amount of borrowings and the average amount of borrowings, as well as weighted average interest rates for the last three years.

(Dollars in thousands)	Federal Funds Purchased and Securities Repurchase Agreements	Commercial Paper	Other Short-Term Borrowings	Total Borrowings
2015				
Balance at December 31, 2015	$130,662	$7,295	$95,272	$233,229
Maximum amount outstanding at any month-end	179,600	14,135	149,783	343,518
Average amount outstanding	145,084	10,722	81,134	236,940
Weighted average interest rate during the year	0.16 %	0.27 %	0.28 %	0.20 %
Weighted average interest rate for outstanding amounts at December 31, 2015	0.29 %	0.28 %	0.38 %	0.33 %
2014				
Balance at December 31, 2014	$138,843	$11,778	$95,201	$245,822
Maximum amount outstanding at any month-end	230,075	17,245	155,573	402,893
Average amount outstanding	143,270	13,137	106,970	263,377
Weighted average interest rate during the year	0.15 %	0.26 %	0.27 %	0.21 %
Weighted average interest rate for outstanding amounts at December 31, 2014	0.13 %	0.27 %	0.29 %	0.20 %
2013				
Balance at December 31, 2013	$181,120	$10,814	$122,197	$314,131
Maximum amount outstanding at any month-end	181,120	16,552	122,197	319,869
Average amount outstanding	121,294	9,035	24,475	154,804
Weighted average interest rate during the year	0.11 %	0.22 %	0.22 %	0.14 %
Weighted average interest rate for outstanding amounts at December 31, 2013	0.17 %	0.24 %	0.28 %	0.22 %

LIQUIDITY

Core Deposits — Our major source of investable funds is provided by stable core deposits consisting of all interest bearing and noninterest bearing deposits, excluding brokered certificates of deposit and certain certificates of deposit over $250,000 based on established FDIC insured deposits. In 2015, average core deposits equaled 74.26% of average total assets, compared to 74.85% in 2014 and 78.35% in 2013. The effective rate of core deposits in 2015 was 0.23%, compared to 0.28% in 2014 and 0.43% in 2013.

Average noninterest bearing core deposits increased 12.08% in 2015 compared to an increase of 10.39% in 2014. These represented 23.03% of total core deposits in 2015, compared to 21.18% in 2014, and 19.12% in 2013.

Table of Contents

Purchased Funds — We use purchased funds to supplement core deposits, which include certain certificates of deposit over $250,000, brokered certificates of deposit, over-night borrowings, securities sold under agreements to repurchase, commercial paper, and other short-term borrowings. Purchased funds are raised from customers seeking short-term investments and are used to manage the Bank’s interest rate sensitivity. During 2015, our reliance on purchased funds increased to 9.79% of average total assets from 9.23% in 2014.

Shareholders’ Equity — Average shareholders’ equity equated to 12.72% of average total assets in 2015, compared to 12.52% in 2014. Shareholders’ equity was 12.41% of total assets at year-end 2015, compared to 12.72% at year-end 2014. We include unrealized gains (losses) on available-for-sale securities, net of income taxes, in accumulated other comprehensive income (loss) which is a component of shareholders’ equity. While regulatory capital adequacy ratios exclude unrealized gains (losses), it does impact our equity as reported in the audited financial statements. The unrealized gains (losses) on available-for-sale securities, net of income taxes, were $6.56 million and $9.41 million at December 31, 2015 and 2014, respectively.

Other Liquidity — Under Indiana law governing the collateralization of public fund deposits, the Indiana Board of Depositories determines which financial institutions are required to pledge collateral based on the strength of their financial ratings. We have been informed that no collateral is required for our public fund deposits. However, the Board of Depositories could alter this requirement in the future and adversely impact our liquidity. Our potential liquidity exposure if we must pledge collateral is approximately $529 million.

Liquidity Risk Management — The Bank’s liquidity is monitored and closely managed by the Asset/Liability Management Committee (ALCO), whose members are comprised of the Bank’s senior management. Asset and liability management includes the management of interest rate sensitivity and the maintenance of an adequate liquidity position. The purpose of interest rate sensitivity management is to stabilize net interest income during periods of changing interest rates.

Liquidity management is the process by which the Bank ensures that adequate liquid funds are available to meet financial commitments on a timely basis. Financial institutions must maintain liquidity to meet day-to-day requirements of depositors and borrowers, take advantage of market opportunities and provide a cushion against unforeseen needs.

Liquidity of the Bank is derived primarily from core deposits, principal payments received on loans, the sale and maturity of investment securities, net cash provided by operating activities, and access to other funding sources. The most stable source of liability-funded liquidity is deposit growth and retention of the core deposit base. The principal source of asset-funded liquidity is available-for-sale investment securities, cash and due from banks, overnight investments, securities purchased under agreements to resell, and loans and interest bearing deposits with other banks maturing within one year. Additionally, liquidity is provided by repurchase agreements, and the ability to borrow from the Federal Reserve Bank (FRB) and the Federal Home Loan Bank (FHLB).

The Bank’s liquidity strategy is guided by internal policies and the Interagency Policy Statement on Funding and Liquidity Risk Management. Internal guidelines consist of:

(i) Available Liquidity (sum of short term borrowing capacity) greater than $500 million;

(ii) Liquidity Ratio (total of net cash, short term investments and unpledged marketable assets divided by the sum of net deposits and short term liabilities) greater than 15%;

(iii) Dependency Ratio (net potentially volatile liabilities minus short term investments divided by total earning assets minus short term investments) less than 15%; and

(iv) Loans to Deposits Ratio less than 100%

At December 31, 2015, we were in compliance with the foregoing internal policies and regulatory guidelines.

The Bank also maintains a contingency funding plan that assesses the liquidity needs under various scenarios of market conditions, asset growth and credit rating downgrades. The plan includes liquidity stress testing which measures various sources and uses of funds under the different scenarios. The contingency plan provides for ongoing monitoring of unused borrowing capacity and available sources of contingent liquidity to prepare for unexpected liquidity needs and to cover unanticipated events that could affect liquidity.

We have borrowing sources available to supplement deposits and meet our funding needs. 1st Source Bank has established relationships with several banks to provide short term borrowings in the form of federal funds purchased.

While at December 31, 2015 there was none outstanding, we could borrow approximately $265.00 million in additional funds for a short time from these banks on a collective basis. As of December 31, 2015, we had $128.04 million outstanding in FHLB advances and could borrow an additional $356.08 million. We also had $424.68 million available to borrow from the FRB with no amounts outstanding as of December 31, 2015.

Table of Contents

Interest Rate Risk Management — ALCO monitors and manages the relationship of earning assets to interest bearing liabilities and the responsiveness of asset yields, interest expense, and interest margins to changes in market interest rates. In the normal course of business, we face ongoing interest rate risks and uncertainties. We may utilize interest rate swaps to partially manage the primary market exposures associated with the interest rate risk related to underlying assets, liabilities, and anticipated transactions.

A hypothetical change in net interest income was modeled by calculating an immediate 200 basis point (2.00%) and 100 basis point (1.00%) increase and a 100 basis point (1.00%) decrease in interest rates across all maturities. The following table shows the aggregate hypothetical impact to pre-tax net interest income.

	Percentage Change in Net Interest Income			
	December 31, 2015		December 31, 2014	
Basis Point Interest Rate Change	12 Months	24 Months	12 Months	24 Months
Up 200	4.41%	9.59%	1.12%	8.15%
Up 100	1.55%	3.95%	(0.23)%	3.50%
Down 100	(2.60)%	(6.57)%	(1.94)%	(6.11)%

The earnings simulation model excludes the earnings dynamics related to how fee income and noninterest expense may be affected by changes in interest rates. Actual results may differ materially from those projected. The use of this methodology to quantify the market risk of the balance sheet should not be construed as an endorsement of its accuracy or the accuracy of the related assumptions.

At December 31, 2015 and 2014, the impact of these hypothetical fluctuations in interest rates on our derivative holdings was not significant, and, as such, separate disclosure is not presented. We manage the interest rate risk related to mortgage loan commitments by entering into contracts for future delivery of loans with outside parties. See Part II, Item 8, Financial Statements and Supplementary Data — Note 18 of the Notes to Consolidated Financial Statements.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

In the ordinary course of operations, we enter into certain contractual obligations. Such obligations include the funding of operations through debt issuances as well as leases for premises and equipment. The following table summarizes our significant fixed, determinable, and estimated contractual obligations, by payment date, at December 31, 2015, except for obligations associated with short-term borrowing arrangements. Payments for borrowings do not include interest. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

The following table shows contractual obligation payments by period.

(Dollars in thousands)	Note	0 – 1 Year	1 – 3 Years	3 – 5 Years	Over 5 Years	Indeterminate maturity	Total
Deposits without stated maturity	—	$2,998,442	$—	$—	$—	$—	$2,998,442
Certificates of deposit	10	510,796	404,867	220,719	4,362	—	1,140,744
Long-term debt	11	6,296	27,268	1,547	4,880	17,388	57,379
Subordinated notes	12	—	—	—	58,764	—	58,764
Operating leases	18	3,492	5,730	4,665	2,117	—	16,004
Purchase obligations	—	22,373	3,969	469	8	—	26,819
Total contractual obligations		$3,541,399	$441,834	$227,400	$70,131	$17,388	$4,298,152

We routinely enter into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for early termination of the contract. We have made a diligent effort to estimate such payments and penalties, where applicable. Additionally, where necessary, we have made reasonable estimates as to certain purchase obligations as of December 31, 2015. Our management has used the best information available to make the estimations necessary to value the related purchase obligations. Our management is not aware of any additional commitments or contingent liabilities which may have a material adverse impact on our liquidity or capital resources at year-end 2015.

We also enter into derivative contracts under which we are required to either receive cash from, or pay cash to, counterparties depending on changes in interest rates. Derivative contracts are carried at fair value on the consolidated balance sheet with the fair value representing the net present value of expected future cash receipts or payments based on market interest rates as of the balance sheet date. The fair value of the contracts changes daily as market interest rates change. Because the derivative assets and liabilities recorded on the balance sheet at December 31, 2015 do not necessarily represent the amounts that may ultimately be paid under these contracts, these assets and liabilities are not included in the table of contractual obligations presented above.

Table of Contents

Assets under management and assets under custody are held in fiduciary or custodial capacity for our clients. In accordance with U.S. generally accepted accounting principles, these assets are not included on our balance sheet. We are also party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our clients. These financial instruments include commitments to extend credit and standby letters of credit. Further discussion of these commitments is included in Part II, Item 8, Financial Statements and Supplementary Data — Note 18 of the Notes to Consolidated Financial Statements.

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth unaudited consolidated selected quarterly statement of operations data for the years ended December 31, 2015 and 2014.

Three Months Ended (Dollars in thousands, except per share amounts)	March 31	June 30	September 30	December 31
2015				
Interest income	$43,632	$46,214	$46,821	$48,017
Interest expense	4,196	4,549	4,612	4,806
Net interest income	39,436	41,665	42,209	43,211
Provision for loan and lease losses	357	811	992	—
Gains on investment securities available-for-sale	—	4	—	—
Income before income taxes	20,769	24,144	21,281	22,369
Net income	13,511	15,630	13,928	14,417
Diluted net income per common share*	0.51	0.59	0.53	0.55
2014				
Interest income	$43,355	$44,850	$45,152	$45,196
Interest expense	4,737	4,688	4,442	4,357
Net interest income	38,618	40,162	40,710	40,839
Provision for (recovery of) loan and lease losses	804	2,543	1,206	(820)
Gains on investment securities available-for-sale	963	—	—	—
Income before income taxes	21,239	22,416	21,243	19,544
Net income	13,632	14,494	14,947	14,996
Diluted net income per common share*	0.50	0.54	0.56	0.57

*The computation of diluted net income per common share gives retrospective recognition to a 10% stock dividend declared July 22, 2015 and issued on August 14, 2015.

Net income was $14.42 million for the fourth quarter of 2015, compared to the $15.00 million of net income reported for the fourth quarter of 2014. Diluted net income per common share for the fourth quarter of 2015 amounted to $0.55, compared to $0.57 per common share reported in the fourth quarter of 2014.

The net interest margin was 3.61% for the fourth quarter of 2015 and 2014. Tax-equivalent net interest income was $43.67 million for the fourth quarter of 2015, up 5.76% from 2014's fourth quarter.

Our provision for loan and lease losses was zero in the fourth quarter of 2015 compared to a recovery of provision for loan and lease losses of $(0.82) million in the fourth quarter of 2014. Net recoveries were $0.50 million for the fourth quarter 2015, compared to net charge-offs of $1.51 million a year ago.

Noninterest income for the fourth quarter of 2015 was $20.90 million, compared to $19.88 million for the fourth quarter of 2014. Noninterest expense for the fourth quarter of 2015 was $41.74 million and was $41.99 million in the fourth quarter 2014.

The provision for income taxes included a one-time benefit of $2.12 million for the fourth quarter of 2014 which resulted in a lower effective tax rate. This benefit was the result of a reduction in uncertain tax positions due to settlements with taxing authorities and the lapse of the applicable statute of limitations.

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

For information regarding Quantitative and Qualitative Disclosures about Market Risk, see Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, Interest Rate Risk Management.

36

Table of Contents

Item 8. Financial Statements and Supplementary Data.
Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
1st Source Corporation
South Bend, Indiana

We have audited the accompanying consolidated statement of financial condition of 1st Source Corporation ("the Company") as of December 31, 2015, and the related consolidated statement of income, comprehensive income, shareholders' equity and cash flows for the year then ended. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of 1st Source Corporation as of December 31, 2015, and the results of its operations and its cash flows for the year ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), 1st Source Corporation 's internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013) and our report dated February 19, 2016 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ BKD, LLP

Fort Wayne, Indiana
February 19, 2016

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of 1st Source Corporation

We have audited the accompanying consolidated statements of financial condition of 1st Source Corporation ("the Company") as of December 31, 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the two years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of 1st Source Corporation at December 31, 2014, and the consolidated results of its operations and its cash flows for each of the two years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Chicago, Illinois
February 20, 2015
except for Note 13 as to which the date is
February 19, 2016

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
1st Source Corporation
South Bend, Indiana

We have audited 1st Source Corporation's internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, 1st Source Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of 1st Source Corporation and our report dated February 19, 2016, expressed an unqualified opinion thereon.

/s/ BKD, LLP

Fort Wayne, Indiana
February 19, 2016

Table of Contents

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

December 31 (Dollars in thousands)	2015	2014
ASSETS		
Cash and due from banks	$65,171	$64,834
Federal funds sold and interest bearing deposits with other banks	14,550	1,356
Investment securities available-for-sale		
(amortized cost of $781,232 and $776,057 at December 31, 2015, and December 31, 2014, respectively)	791,727	791,118
Other investments	21,973	20,801
Trading account securities	—	205
Mortgages held for sale	9,825	13,604
Loans and leases, net of unearned discount:		
Commercial and agricultural	744,749	710,758
Auto and light truck	425,236	397,902
Medium and heavy duty truck	278,254	247,153
Aircraft financing	778,012	727,665
Construction equipment financing	455,565	399,940
Commercial real estate	700,268	616,587
Residential real estate	464,129	445,759
Consumer	148,479	142,810
Total loans and leases	3,994,692	3,688,574
Reserve for loan and lease losses	(88,112)	(85,068)
Net loans and leases	3,906,580	3,603,506
Equipment owned under operating leases, net	110,371	74,143
Net premises and equipment	53,191	50,328
Goodwill and intangible assets	84,676	85,371
Accrued income and other assets	129,852	124,692
Total assets	$5,187,916	$4,829,958
LIABILITIES		
Deposits:		
Noninterest bearing	$902,364	$796,241
Interest bearing	3,236,822	3,006,619
Total deposits	4,139,186	3,802,860
Short-term borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	130,662	138,843
Other short-term borrowings	102,567	106,979
Total short-term borrowings	233,229	245,822
Long-term debt and mandatorily redeemable securities	57,379	56,232
Subordinated notes	58,764	58,764
Accrued expenses and other liabilities	55,305	51,807
Total liabilities	4,543,863	4,215,485
SHAREHOLDERS' EQUITY		
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 shares at December 31, 2015 and 28,206,076 shares at December 31, 2014*	436,538	346,535
Retained earnings	251,812	302,242

Cost of common stock in treasury (2,178,090 shares at December 31, 2015 and 1,957,386 shares at December 31, 2014)*	(50,852)	(43,711)
Accumulated other comprehensive income	6,555	9,407
Total shareholders’ equity	644,053	614,473
Total liabilities and shareholders’ equity	$5,187,916	$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

CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 (Dollars in thousands, except per share amounts)	2015	2014	2013
Interest income:			
Loans and leases	$168,766	$161,215	$161,137
Investment securities, taxable	11,929	13,054	14,414
Investment securities, tax-exempt	2,992	3,269	3,094
Other	997	1,016	940
Total interest income	184,684	178,554	179,585
Interest expense:			
Deposits	11,489	11,356	16,604
Short-term borrowings	484	541	211
Subordinated notes	4,220	4,220	4,220
Long-term debt and mandatorily redeemable securities	1,970	2,108	1,733
Total interest expense	18,163	18,225	22,768
Net interest income	166,521	160,329	156,817
Provision for loan and lease losses	2,160	3,733	772
Net interest income after provision for loan and lease losses	164,361	156,596	156,045
Noninterest income:			
Trust fees	19,126	18,511	17,383
Service charges on deposit accounts	9,313	8,684	9,177
Debit card income	10,217	9,585	8,882
Mortgage banking income	4,570	5,381	5,944
Insurance commissions	5,465	5,556	5,492
Equipment rental income	22,302	17,156	16,229
Gains (losses) on investment securities available-for-sale	4	963	(168)
Other income	12,319	12,051	14,273
Total noninterest income	83,316	77,887	77,212
Noninterest expense:			
Salaries and employee benefits	86,133	80,488	79,783
Net occupancy expense	9,768	9,311	8,700
Furniture and equipment expense	18,348	17,657	16,895
Depreciation — leased equipment	18,280	13,893	13,055
Professional fees	4,682	5,046	5,321
Supplies and communication	6,011	5,589	5,690
FDIC and other insurance	3,412	3,384	3,462
Business development and marketing expense	4,837	6,049	4,938
Loan and lease collection and repossession expense	667	1,102	4,030
Other expense	6,976	7,521	7,440
Total noninterest expense	159,114	150,040	149,314
Income before income taxes	88,563	84,443	83,943
Income tax expense	31,077	26,374	28,985
Net income	$57,486	$58,069	$54,958
Basic net income per common share*	$2.17	$2.17	$2.03
Diluted net income per common share*	$2.17	$2.17	$2.03

*The computation of basic and diluted net income per common share 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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Year Ended December 31 (Dollars in thousands)	2015	2014	2013
Net income	$57,486	$58,069	$54,958
Other comprehensive (loss) income:			
Change in unrealized (depreciation) appreciation of available-for-sale securities	(4,562)	5,488	(20,915)
Reclassification adjustment for realized (gains) losses included in net income	(4)	(963)	168
Income tax effect	1,714	(1,699)	7,789
Other comprehensive (loss) income, net of tax	(2,852)	2,826	(12,958)
Comprehensive income	$54,634	$60,895	$42,000

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Retained Earnings	Cost of Common Stock in Treasury	Accumulated Other Comprehensive Income (Loss), Net	Total
Balance at January 1, 2013	$—	$346,535	$223,715	$(31,134)	$ 19,539	$558,655
Net income	—	—	54,958	—	—	54,958
Other comprehensive loss	—	—	—	—	(12,958)	(12,958)
Issuance of 186,936 common shares under stock based compensation awards, including related tax effects*	—	—	(388)	4,043	—	3,655
Cost of 99,064 shares of common stock acquired for treasury*	—	—	—	(2,273)	—	(2,273)
Common stock dividend ($0.618 per share)*	—	—	(16,659)	—	—	(16,659)
Balance at December 31, 2013	$—	$346,535	$261,626	$(29,364)	$ 6,581	$585,378
Net income	—	—	58,069	—	—	58,069
Other comprehensive income	—	—	—	—	2,826	2,826
Issuance of 91,675 common shares under stock based compensation awards, including related tax effects*	—	—	(243)	1,995	—	1,752
Cost of 597,747 shares of common stock acquired for treasury*	—	—	—	(16,342)	—	(16,342)
Common stock dividend ($0.645 per share)*	—	—	(17,210)	—	—	(17,210)
Balance at December 31, 2014	$—	$346,535	$302,242	$(43,711)	$ 9,407	$614,473
Net income	—	—	57,486	—	—	57,486
Other comprehensive loss	—	—	—	—	(2,852)	(2,852)
Issuance of 118,281 common shares under stock based compensation awards, including related tax effects*	—	—	(245)	2,829	—	2,584
Cost of 338,985 shares of common stock acquired for treasury*	—	—	—	(9,970)	—	(9,970)
Common stock dividend ($0.671 per share)*	—	—	(17,655)	—	—	(17,655)
10% common stock dividend ($13 cash paid in lieu of fractional shares)	—	90,003	(90,016)	—	—	(13)
Balance at December 31, 2015	$—	$436,538	$251,812	$(50,852)	$ 6,555	$644,053

*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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31 (Dollars in thousands)	2015	2014	2013
Operating activities:			
Net income	$57,486	$58,069	$54,958
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses	2,160	3,733	772
Depreciation of premises and equipment	4,780	4,748	4,727
Depreciation of equipment owned and leased to others	18,280	13,893	13,055
Stock-based compensation	3,843	3,179	2,897
Amortization of investment securities premiums and accretion of discounts, net	4,652	4,351	3,499
Amortization of mortgage servicing rights	1,424	1,278	1,571
Deferred income taxes	1,620	4,341	(1,947)
(Gains) losses on investment securities available-for-sale	(4)	(963)	168
Originations of loans held for sale, net of principal collected	(113,029)	(121,440)	(102,195)
Proceeds from the sales of loans held for sale	120,138	117,447	110,390
Net gain on sale of loans held for sale	(3,330)	(3,532)	(3,395)
Net gain on sale of other real estate and repossessions	(814)	(1,624)	(499)
Change in trading account securities	205	(13)	(46)
Change in interest receivable	(549)	(603)	160
Change in interest payable	798	(917)	(1,883)
Change in other assets	(7,807)	(9,278)	7,846
Change in other liabilities	8,010	(2,481)	(3,770)
Other	3,168	2,733	738
Net change in operating activities	101,031	72,921	87,046
Investing activities:			
Proceeds from sales of investment securities available-for-sale	1,299	1,236	48,888
Proceeds from maturities and paydowns of investment securities available-for-sale	136,649	190,323	175,875
Purchases of investment securities available-for-sale	(147,771)	(148,841)	(201,029)
Net change in other investments	(1,172)	1,599	209
Loans sold or participated to others	1,962	16,889	25,054
Net change in loans and leases	(315,938)	(165,463)	(255,345)
Net change in equipment owned under operating leases	(54,508)	(27,069)	(21,849)
Purchases of premises and equipment	(9,498)	(8,489)	(6,508)
Proceeds from sales of other real estate and repossessions	6,941	10,418	3,307
Net change in investing activities	(382,036)	(129,397)	(231,398)
Financing activities:			
Net change in demand deposits and savings accounts	173,508	102,130	166,683
Net change in time deposits	162,818	47,080	(137,380)
Net change in short-term borrowings	(12,593)	(68,309)	144,943
Proceeds from issuance of long-term debt	—	7,161	6,502
Payments on long-term debt	(1,250)	(11,660)	(21,119)
Stock issued under stock purchase plans	149	197	168
Acquisition of treasury stock	(9,970)	(16,342)	(2,273)
Cash dividends paid on common stock	(18,126)	(17,643)	(17,054)
Net change in financing activities	294,536	42,614	140,470
Net change in cash and cash equivalents	13,531	(13,862)	(3,882)

Cash and cash equivalents, beginning of year	66,190	80,052	83,934
Cash and cash equivalents, end of year	$79,721	$66,190	$80,052
Supplemental Information:			
Non-cash transactions:			
Loans transferred to other real estate and repossessions	$8,742	$7,154	$7,942
Common stock matching contribution to Employee Stock Ownership and Profit Sharing Plan	500	—	2,801
Stock dividend paid on common stock	90,003	—	—
Cash paid for:			
Interest	$17,364	$19,143	$24,651
Income taxes	30,429	29,211	33,831

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. 1st Source Bank (“Bank”), its banking subsidiary, offers commercial and consumer banking services, trust and investment management services, and insurance to individual and business clients in Indiana and Michigan. The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements.

Basis of Presentation — The financial statements consolidate 1st Source and its subsidiaries (principally the Bank). All significant intercompany balances and transactions have been eliminated. For purposes of the parent company only financial information presented in Note 22, investments in subsidiaries are carried at equity in the underlying net assets.

Use of Estimates in the Preparation of Financial Statements — Financial statements prepared in accordance with U.S. generally accepted accounting principles (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 expenses during the reporting period. Actual results could differ from those estimates.

Business Combinations — Business combinations are accounted for under the purchase method of accounting. Under the purchase method, assets and liabilities of the business acquired are recorded at their estimated fair values as of the date of acquisition with any excess of the cost of the acquisition over the fair value of the net tangible and intangible assets acquired recorded as goodwill. Results of operations of the acquired business are included in the income statement from the date of acquisition.

Cash Flows — For purposes of the consolidated and parent company only statements of cash flows, the Company considers cash and due from banks, federal funds sold and interest bearing deposits with other banks with original maturities of three months or less as cash and cash equivalents.

Securities — Securities that the Company has the ability and positive intent to hold to maturity are classified as investment securities held-to-maturity. Held-to-maturity investment securities, when present, are carried at amortized cost. As of December 31, 2015 and 2014, the Company held no securities classified as held-to-maturity. Securities that may be sold in response to, or in anticipation of, changes in interest rates and resulting prepayment risk, or for other factors, are classified as available-for-sale and are carried at fair value. Unrealized gains and losses on these securities are reported, net of applicable taxes, as a separate component of accumulated other comprehensive income (loss) in shareholders’ equity.

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, any 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 an anticipated recovery of cost.

Debt and equity securities that are purchased and held principally for the purpose of selling them in the near term are classified as trading account securities and are carried at fair value with unrealized gains and losses reported in earnings. Realized gains and losses on the sales of all securities are reported in earnings and computed using the specific identification cost basis.

Other investments consist of shares of Federal Home Loan Bank of Indianapolis (FHLBI) and Federal Reserve Bank stock. As restricted member stocks, these investments are carried at cost. Both cash and stock dividends received on the stocks are reported as income. Quarterly, the Company reviews its investment in FHLBI for impairment. Factors considered in determining impairment are: history of dividend payments; determination of cause for any net loss;

adequacy of capital; and review of the most recent financial statements. As of December 31, 2015 and 2014, it was determined that the Company's investment in FHLBI stock is appropriately valued at cost, which equates to par value. In addition, other investments include interest bearing deposits with other banks with original maturities of greater than three months. These investments are in denominations, including accrued interest, that are fully insured by the FDIC.

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.

Table of Contents

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.

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.

The Company sells mortgage loans to the Government National Mortgage Association (GNMA) in the normal course of business and retains the servicing rights. The GNMA programs under which the loans are sold allow the Company to repurchase individual delinquent loans that meet certain criteria from the securitized loan pool. At its option, and without GNMA's prior authorization, the Company may repurchase a delinquent loan for an amount equal to 100% of the remaining principal balance on the loan. Once the Company has the unconditional ability to repurchase a delinquent loan, the Company is deemed to have regained effective control over the loan and the Company is required to recognize the loan on its balance sheet and record an offsetting liability, regardless of its intent to repurchase the loan. At December 31, 2015 and 2014, residential real estate portfolio loans included $5.27 million and $5.20 million, respectively, of loans available for repurchase under the GNMA optional repurchase programs with the offsetting liability recorded within other short-term borrowings.

Mortgage Banking Activities — Loans held for sale are composed of performing one-to-four family residential mortgage loans originated for resale. Mortgage loans originated with the intent to sell are carried at fair value.

The Company recognizes the rights to service mortgage loans for others as separate assets, whether the servicing rights are acquired through a separate purchase or through the sale of originated loans with servicing rights retained. The Company allocates a portion of the total proceeds of a mortgage loan to servicing rights based on the relative fair value. These assets are amortized as reductions of mortgage servicing fee income over the estimated servicing period in proportion to the estimated servicing income to be received. Gains and losses on the sale of MSRs are recognized in Noninterest Income on the Statements of Income in the period in which such rights are sold.

MSRs are evaluated for impairment at each reporting date. For purposes of impairment measurement, MSRs are stratified based on the predominant risk characteristics of the underlying servicing, principally by loan type. If temporary impairment exists within a tranche, a valuation allowance is established through a charge to income equal to the amount by which the carrying value exceeds the fair value. If it is later determined all or a portion of the temporary impairment no longer exists for a particular tranche, the valuation allowance is reduced through a recovery of income.

MSRs are also reviewed for other-than-temporary impairment. Other-than-temporary impairment exists when recoverability of a recorded valuation allowance is determined to be remote considering historical and projected interest rates, prepayments, and loan pay-off activity. When this situation occurs, the unrecoverable portion of the valuation allowance is applied as a direct write-down to the carrying value of the MSRs. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the MSRs and the valuation allowance, precluding subsequent recoveries.

As part of mortgage banking operations, the Company enters into commitments to originate loans whereby the interest rate on these loans is determined prior to funding ("rate lock commitments"). Similar to loans held for sale, the fair value of rate lock commitments is subject to change primarily due to changes in interest rates. Under the Company's risk management policy, these fair values are hedged primarily by selling forward contracts on agency securities. The rate lock commitments on mortgage loans intended to be sold and the related hedging instruments are recorded at fair value with changes in fair value recorded in current earnings.

Reserve for Loan and Lease Losses — 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 homogenous 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.

Specific reserves are established for certain business and specialty finance credits based on a regular analysis of special attention loans and leases. This analysis is performed by the Credit Policy Committee (CPC), the Loan Review Department, Credit Administration, and the Loan Workout Departments. The specific reserves are based on an analysis of underlying collateral values, cash flow considerations and, if applicable, guarantor capacity. Sources for determining collateral values include appraisals, evaluations, auction values and industry guides. Generally, for loans secured by commercial real estate and dependent on cash flows from the underlying collateral to service the debt, a new appraisal is obtained at the time the credit is deemed to be impaired. For non-income producing commercial real estate, an appraisal or evaluation is ordered depending on an analysis of the underlying factors, including an assessment of the overall credit worthiness of the borrower, the value of non-real estate collateral supporting the transaction and the date of the most recent existing appraisal or evaluation. An evaluation may be performed in lieu of obtaining a new appraisal for less complex transactions secured by local market properties. Values based on evaluations are discounted more heavily than those determined by appraisals when calculating loan impairment. Appraisals, evaluations and industry guides are used to determine aircraft values. Appraisals, industry guides and auction values are used to determine construction equipment, truck and auto values.

The formula reserves determined for each business lending division portfolio are calculated quarterly by applying loss factors to outstanding loans and leases based upon a review of historical loss experience and qualitative factors, which include but are not limited to, economic trends, current market risk assessment by industry, recent loss experience in particular segments of the portfolios, movement in equipment values collateralizing specialized industry portfolios, concentrations of credit, delinquencies, trends in volume, experience and depth of relationship managers and division management, and the effects of changes in lending policies and practices, including changes in quality of the loan and lease origination, servicing and risk management processes. Special attention loans and leases without specific reserves receive a higher percentage allocation ratio than credits not considered special attention.

Pooled loans and leases are smaller credits and are homogenous in nature, such as consumer credits and residential mortgages. Pooled loan and lease loss reserves are based on historical net charge-offs, adjusted for delinquencies, the effects of lending practices and programs and current economic conditions, and current trends in the geographic markets which the Company serves.

A comprehensive analysis of the reserve is performed on a quarterly basis by reviewing all loans and leases over a fixed dollar amount ($100,000) where the internal credit quality grade is at or below a predetermined classification. Although the Company determines the amount of each element of the reserve separately and relies on this process as an important credit management tool, the entire reserve is available for the entire loan and lease portfolio. The actual amount of losses incurred can vary significantly from the estimated amounts both positively and negatively. The Company's methodology includes several factors intended to minimize the difference between estimated and actual losses. These factors allow the Company to adjust its estimate of losses based on the most recent information available.

Table of Contents

Impaired loans are reviewed quarterly to assess the probability of being able to collect the portion considered impaired. When a review and analysis of the underlying credit and collateral indicates ultimate collection is improbable, the deficiency is charged-off and deducted from the reserve. Loans and leases, which are deemed uncollectible or have a low likelihood of collection, are charged-off and deducted from the reserve, while recoveries of amounts previously charged-off are credited to the reserve. A (recovery of) provision for loan and lease losses is credited or charged to operations based on the Company’s periodic evaluation of the factors previously mentioned, as well as other pertinent factors.

Equipment Owned Under Operating Leases — The Company finances various types of construction equipment, medium and heavy duty trucks, automobiles and other equipment under leases classified as operating leases. The equipment underlying the operating leases is reported at cost, net of accumulated depreciation, in the Statements of Financial Condition. These operating lease arrangements require the lessee to make a fixed monthly rental payment over a specified lease term generally ranging from three to seven years. Revenue consists of the contractual lease payments and is recognized on a straight-line basis over the lease term and reported as noninterest income. Leased assets are being depreciated on a straight-line method over the lease term to the estimate of the equipment’s fair market value at lease termination, also referred to as “residual” value. The depreciation of these operating lease assets is reported as Noninterest Expense on the Statements of Income. For automobile leases, fair value is based upon published industry market guides. For other equipment leases, fair value may be based upon observable market prices, third-party valuations, or prices received on sales of similar assets at the end of the lease term. These residual values are reviewed periodically to ensure the recorded amount does not exceed the fair market value at the lease termination. At the end of the lease, the operating lease asset is either purchased by the lessee or returned to the Company.

Other Real Estate — Other real estate acquired through partial or total satisfaction of nonperforming loans is included in Other Assets and recorded at fair value less anticipated selling costs based upon the property’s appraised value at the date of transfer, with any difference between the fair value of the property less cost to sell, and the carrying value of the loan charged to the reserve for loan losses or other income, if a positive adjustment. Subsequent fair value write-downs or write-ups, to the extent of previous write-downs, property maintenance costs, and gains or losses recognized upon the sale of other real estate are recognized in Noninterest Expense on the Statements of Income. Gains or losses resulting from the sale of other real estate are recognized on the date of sale. As of December 31, 2015 and 2014, other real estate had carrying values of $0.74 million and $1.74 million, respectively, and is included in Other Assets in the Statements of Financial Condition.

Repossessed Assets — Repossessed assets may include fixtures and equipment, inventory and receivables, aircraft, construction equipment, and vehicles acquired from business banking and specialty finance activities. Repossessed assets are included in Other Assets at fair value of the equipment or vehicle less estimated selling costs. At the time of repossession, the recorded amount of the loan or lease is written down to the fair value of the equipment or vehicle by a charge to the reserve for loan and lease losses or other income, if a positive adjustment. Subsequent fair value write-downs or write-ups, to the extent of previous write-downs, equipment maintenance costs, and gains or losses recognized upon the sale of repossessions are recognized in Noninterest Expense on the Statements of Income. Gains or losses resulting from the sale of repossessed assets are recognized on the date of sale. Repossessed assets totaled $6.93 million and $5.16 million, as of December 31, 2015 and 2014, respectively, and are included in Other Assets in the Statements of Financial Condition.

Premises and Equipment — Premises and equipment are stated at cost, less accumulated depreciation and amortization. The provision for depreciation is computed by the straight-line method, primarily with useful lives ranging from three to 31.5 years. Maintenance and repairs are charged to expense as incurred, while improvements, which extend the useful life, are capitalized and depreciated over the estimated remaining life.

Goodwill and Intangibles — Goodwill represents the excess of the cost of businesses acquired over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Goodwill is reviewed for impairment at least annually or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the carrying amount. Goodwill is allocated into two reporting units. Fair value for each reporting unit is estimated using stock price multiples or revenue multiples. Intangible assets that have finite lives are amortized over their estimated useful lives and are subject to impairment testing. All of the Company's other intangible assets have finite lives and are amortized on a straight-line basis over varying periods not exceeding twenty-five years. The Company performed the required annual impairment test of goodwill during the fourth quarter of 2015 and determined that no impairment exists.

Partnership Investment — The Company accounts for its investments in partnerships for which it owns three percent or more of the partnership on the equity method. The partnerships in which the Company has investments account for their investments at fair value. As a result, the Company's investments in these partnerships reflect the underlying fair value of the partnerships' investments. The Company accounts for its investments in partnerships of which it owns less than three percent at the lower of cost or fair value. Investments in partnerships are included in Other Assets in the Statements of Financial Condition. The balances as of December 31, 2015 and 2014 were \$2.38 million and \$2.78 million, respectively.

Table of Contents

Short-Term Borrowings — Short-term borrowings consist of Federal funds purchased, securities sold under agreements to repurchase, commercial paper, Federal Home Loan Bank notes, and borrowings from non-affiliated banks. Federal funds purchased, securities sold under agreements to repurchase, and other short-term borrowings mature within one to 365 days of the transaction date. Commercial paper matures within seven to 270 days. Other short-term borrowings in the Statements of Financial Condition include the Company's liability related to mortgage loans available for repurchase under GNMA optional repurchase programs.

Securities purchased under agreements to resell and securities sold under agreements to repurchase are treated as collateralized financing transactions and are recorded at the amounts at which the securities were acquired or sold plus accrued interest. The fair value of collateral either received from or provided to a third party is continually monitored and additional collateral obtained or requested to be returned to the Company as deemed appropriate.

Trust Fees — Trust fees are recognized on the accrual basis.

Income Taxes — 1st Source and its subsidiaries file a consolidated Federal income tax return. The provision for incomes taxes is based upon income in the consolidated financial statements, rather than amounts reported on the income tax return. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years. Although realization is not assured, the Company believes it is more likely than not that all of the deferred tax assets will be realized.

Positions taken in the tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within Income Tax Expense in the Statements of Income.

Net Income Per Common Share — Basic earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of shares of common stock outstanding. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of shares of common stock outstanding, plus the dilutive effect of outstanding stock options, stock warrants and nonvested stock-based compensation awards.

Stock-Based Employee Compensation — The Company recognizes stock-based compensation as compensation cost in the Statements of Income based on their fair values on the measurement date, which, for its purposes, is the date of grant.

Segment Information — 1st Source has one principal business segment, commercial banking. While our chief decision makers monitor the revenue streams of various products and services, the identifiable segments' operations are managed and financial performance is evaluated on a company-wide basis. Accordingly, all of the Company's financial service operations are considered to be aggregated in one reportable operating segment.

Derivative Financial Instruments — The Company occasionally enters into derivative financial instruments as part of its interest rate risk and foreign currency risk management strategies. These derivative financial instruments consist primarily of interest rate swaps and foreign currency forward contracts. All derivative instruments are recorded on the Statements of Financial Condition, as either an asset or liability, at their fair value. The accounting for the gain or loss resulting from the change in fair value depends on the intended use of the derivative. For a derivative used to hedge changes in fair value of a recognized asset or liability, or an unrecognized firm commitment, the gain or loss on the derivative will be recognized in earnings together with the offsetting loss or gain on the hedged item. This results in an earnings impact only to the extent that the hedge is ineffective in achieving offsetting changes in fair value. If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting is discontinued and the adjustment to fair value of the derivative instrument is recorded in earnings. For a derivative used to hedge changes in cash flows associated with forecasted transactions, the gain or loss on the effective portion of the derivative will be deferred, and reported as accumulated other comprehensive income, a component of shareholders' equity, until such time the hedged transaction affects earnings. For derivative instruments not accounted for as hedges, changes in fair value are recognized in noninterest income/expense. Deferred gains and losses from derivatives that are terminated and were in a cash flow hedge are amortized over the shorter of the original remaining term of the derivative or the remaining life of the underlying asset or liability.

Table of Contents

Fair Value Measurements — The Company records certain assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, trading securities, mortgage loans held for sale, and derivative instruments are carried at fair value on a recurring basis. Fair value measurements are also utilized to determine the initial value of certain assets and liabilities, to perform impairment assessments, and for disclosure purposes. The Company uses quoted market prices and observable inputs to the maximum extent possible when measuring fair value. In the absence of quoted market prices, various valuation techniques are utilized to measure fair value. When possible, observable market data for identical or similar financial instruments are used in the valuation. When market data is not available, fair value is determined using valuation models that incorporate management's estimates of the assumptions a market participant would use in pricing the asset or liability.

Fair value measurements are classified within one of three levels based on the observability of the inputs used to determine fair value, as follows:

Level 1 — The valuation is based on quoted prices in active markets for identical instruments.

Level 2 — The valuation is based on observable inputs such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 — The valuation is based on unobservable inputs that are supported by minimal or no market activity and that are significant to the fair value of the instrument. Level 3 valuations are typically performed using pricing models, discounted cash flow methodologies, or similar techniques that incorporate management's own estimates of assumptions that market participants would use in pricing the instrument, or valuations that require significant management judgment or estimation.

Reclassifications — Certain amounts in the prior periods consolidated financial statements have been reclassified to conform with the current year presentation. These reclassifications had no effect on total assets, shareholders' equity or net income as previously reported.

Note 2 — Recent Accounting Pronouncements

Recognition and Measurement of Financial Instruments: In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01 "Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 is intended to improve the recognition and measurement of financial instruments by requiring equity investments to be measured at fair value with changes in fair value recognized in net income; requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured and amortized at cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. The Company is assessing the impact of ASU 2016-01 on its accounting and disclosures.

Short Duration Contracts: In May 2015, the 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 accounting and disclosures.

Table of Contents

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 adopted ASU 2015-02 on January 1, 2016 and it did not have an impact on its accounting and disclosures.
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 continues to assess the impact of ASU 2014-09 on its accounting and disclosures.

Note 3 — Investment Securities

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

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Fair Value
December 31, 2015					
U.S. Treasury and Federal agencies securities	$389,457	$ 1,718	$ (1,506	)	$389,669
U.S. States and political subdivisions securities	120,441	2,692	(143	)	122,990
Mortgage-backed securities - Federal agencies	234,400	3,430	(1,533	)	236,297
Corporate debt securities	34,241	199	(57	)	34,383
Foreign government and other securities	800	10	(1	)	809
Total debt securities	779,339	8,049	(3,240	)	784,148
Marketable equity securities	1,893	5,906	(220	)	7,579
Total investment securities available-for-sale	$781,232	$ 13,955	$ (3,460	)	$791,727
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
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 December 31, 2015, 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 debt securities available-for-sale at December 31, 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	$83,635	$84,161
Due after one year through five years	442,622	444,585
Due after five years through ten years	18,682	19,105
Due after ten years	—	—
Mortgage-backed securities	234,400	236,297
Total debt securities available-for-sale	$779,339	$784,148

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.

(Dollars in thousands)	2015	2014	2013
Gross realized gains	$4	$963	$903
Gross realized losses	—	—	(1,071)
Net realized gains (losses)	$4	$963	$(168)

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

	Less than 12 Months		12 months or Longer		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2015						
U.S. Treasury and Federal agencies securities	$151,581	$(928)	$43,372	$(578)	$194,953	$(1,506)
U.S. States and political subdivisions securities	17,040	(79)	3,795	(64)	20,835	(143)
Mortgage-backed securities - Federal agencies	78,731	(777)	20,592	(756)	99,323	(1,533)
Corporate debt securities	9,340	(57)	—	—	9,340	(57)
Foreign government and other securities	99	(1)	—	—	99	(1)
Total debt securities	256,791	(1,842)	67,759	(1,398)	324,550	(3,240)
Marketable equity securities	427	(218)	3	(2)	430	(220)
Total temporarily impaired available-for-sale securities	$257,218	$(2,060)	$67,762	$(1,400)	$324,980	$(3,460)
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 temporarily impaired available-for-sale securities	$96,575	$(348)	$156,312	$(2,643)	$252,887	$(2,991)

There were no OTTI write-downs in 2015, 2014 or 2013.

At December 31, 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. The unrealized losses on debt securities are due to market volatility. The fair value is expected to recover on all debt securities as they approach their maturity date or repricing 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 December 31, 2015 and 2014, investment securities with carrying values of $233.14 million and $231.50 million, respectively, were pledged as collateral for security repurchase agreements and for other purposes.

Table of Contents

Note 4 — Loan and Lease Financings

Total loans and leases outstanding were recorded net of unearned income and deferred loan fees and costs at December 31, 2015 and 2014, and totaled $3.99 billion and $3.69 billion, respectively. At December 31, 2015 and 2014, net deferred loan and lease costs were $3.96 million and $4.00 million, respectively.

The loan and lease portfolio includes direct financing leases, which are included in auto and light truck, medium and heavy duty truck, aircraft financing, and construction equipment financing on the Statements of Financial Condition. The following table shows the summary of the gross investment in lease financing and the components of the investment in lease financing at December 31, 2015 and 2014.

(Dollars in thousands)	2015	2014
Direct finance leases:		
Rentals receivable	$206,426	$234,772
Estimated residual value of leased assets	15,756	13,458
Gross investment in lease financing	222,182	248,230
Unearned income	(32,499)	(37,356)
Net investment in lease financing	$189,683	$210,874

At December 31, 2015, the direct financing minimum future lease payments receivable for each of the years 2016 through 2020 were $44.53 million, $41.61 million, $36.23 million, $29.36 million, and $25.19 million, respectively.

In the ordinary course of business, the Company has extended loans to certain directors, executive officers, and principal shareholders of equity securities of 1st Source and to their affiliates. In the opinion of management, these loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not related to the Company and did not involve more than the normal risk of collectability, or present other unfavorable features. The loans are consistent with sound banking practices and within applicable regulatory and lending limitations. The aggregate dollar amounts of these loans were $33.36 million and $27.93 million at December 31, 2015 and 2014, respectively. During 2015, $14.34 million of new loans and other additions were made and repayments and other reductions totaled $8.91 million.

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 our 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 our 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).

Table of Contents

The following table shows the credit quality grades of the recorded investment in loans and leases, segregated by class.

	Credit Quality Grades		
(Dollars in thousands)	1-6	7-12	Total
December 31, 2015			
Commercial and agricultural	$710,030	$34,719	$744,749
Auto and light truck	413,836	11,400	425,236
Medium and heavy duty truck	275,367	2,887	278,254
Aircraft financing	750,264	27,748	778,012
Construction equipment financing	448,683	6,882	455,565
Commercial real estate	680,304	19,964	700,268
Total	$3,278,484	$103,600	$3,382,084
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
Total	$2,985,162	$114,843	$3,100,005

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
December 31, 2015			
Residential real estate	$462,236	$1,893	$464,129
Consumer	148,180	299	148,479
Total	$610,416	$2,192	$612,608
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

Table of Contents

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 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Accruing	Total Accruing Loans	Nonaccrual	Total Financing Receivables
December 31, 2015							
Commercial and agricultural	$740,335	$52	$79	$ —	$ 740,466	$ 4,283	$744,749
Auto and light truck	424,997	170	23	—	425,190	46	425,236
Medium and heavy duty truck	278,254	—	—	—	278,254	—	278,254
Aircraft financing	764,074	9,442	108	—	773,624	4,388	778,012
Construction equipment financing	454,993	33	—	—	455,026	539	455,565
Commercial real estate	698,514	362	—	—	698,876	1,392	700,268
Residential real estate	460,771	1,038	427	71	462,307	1,822	464,129
Consumer	147,419	552	209	51	148,231	248	148,479
Total	$3,969,357	$11,649	$846	$ 122	$ 3,981,974	$ 12,718	$3,994,692
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

Interest income for the years ended December 31, 2015, 2014, and 2013, would have increased by approximately $1.03 million, $3.03 million, and $2.93 million, respectively, if the nonaccrual loans and leases had earned interest at their full contract rate.

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 Investment	Unpaid Principal Balance	Related Reserve
December 31, 2015			
With no related reserve recorded:			
Commercial and agricultural	$1,016	$1,016	$—
Auto and light truck	—	—	—
Medium and heavy duty truck	—	—	—
Aircraft financing	4,384	4,384	—
Construction equipment financing	539	539	—
Commercial real estate	8,494	8,494	—
Residential real estate	—	—	—
Consumer	—	—	—
Total with no related reserve recorded	14,433	14,433	—
With a reserve recorded:			
Commercial and agricultural	2,884	2,884	649
Auto and light truck	—	—	—
Medium and heavy duty truck	—	—	—
Aircraft financing	—	—	—
Construction equipment financing	—	—	—
Commercial real estate	—	—	—
Residential real estate	366	368	148
Consumer	—	—	—
Total with a reserve recorded	3,250	3,252	797
Total impaired loans	$17,683	$17,685	$797
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

Table of Contents

The following table shows average recorded investment and interest income recognized on impaired loans and leases, segregated by class, for years ending December 31, 2015, 2014 and 2013.

(Dollars in thousands)	2015 Average Recorded Investment	2015 Interest Income	2014 Average Recorded Investment	2014 Interest Income	2013 Average Recorded Investment	2013 Interest Income
Commercial and agricultural	$5,362	$32	$16,325	$48	$10,077	$143
Auto and light truck	—	—	407	—	488	—
Medium and heavy duty truck	—	—	—	—	431	—
Aircraft financing	7,285	6	4,088	28	9,254	79
Construction equipment financing	695	—	938	—	2,799	5
Commercial real estate	10,126	518	13,162	588	17,655	610
Residential real estate	370	16	376	16	32	—
Consumer loans	—	—	—	—	—	—
Total	$23,838	$572	$35,296	$680	$40,736	$837

The following table shows the number of loans and leases classified as troubled debt restructuring (TDR) during 2015, 2014 and 2013, segregated by class, as well as the recorded investment as of December 31. The classification between nonperforming and performing is shown at the time of modification. Modification programs focused 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, three modifications during 2014, and two modifications during 2013 that resulted in an interest rate reduction below market rate. Consequently, the financial impact of the modifications was immaterial.

(Dollars in thousands)	2015 Number of Modifications	2015 Recorded Investment	2014 Number of Modifications	2014 Recorded Investment	2013 Number of Modifications	2013 Recorded Investment
Performing TDRs:						
Commercial and agricultural	2	$218	2	$273	1	$750
Auto and light truck	—	—	—	—	—	—
Medium and heavy duty truck	—	—	—	—	—	—
Aircraft financing	—	—	2	337	—	—
Construction equipment financing	—	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—
Residential real estate	—	—	—	—	1	381
Consumer	—	—	—	—	—	—
Total performing TDR modifications	2	218	4	610	2	1,131
Nonperforming TDRs:						
Commercial and agricultural	—	—	4	7,315	1	158
Auto and light truck	—	—	—	—	—	—
Medium and heavy duty truck	—	—	—	—	—	—
Aircraft financing	—	—	—	—	1	4,157
Construction equipment financing	—	—	—	—	—	—
Commercial real estate	—	—	1	798	—	—
Residential real estate	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
	—	—	5	8,113	2	4,315

Total nonperforming TDR modifications						
Total TDR modifications	2	$218	9	$8,723	4	$5,446

There were no performing TDRs which had payment defaults within the twelve months following modification during the years ended December 31, 2015 and 2014 and one commercial and agricultural loan during 2013 with a recorded investment of $0.75 million at December 31, 2013.

There were no nonperforming TDRs which had payment defaults within the twelve months following modification during the year ended December 31, 2015, one commercial and agricultural loan during 2014 with a recorded investment of $0.26 million at December 31, 2014 and one commercial real estate loan during 2013 with a recorded investment of zero at December 31, 2013.

Table of Contents

The classification between nonperforming and performing is shown at the time of modification. 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 December 31.

Year Ended December 31 (Dollars in thousands)	2015	2014
Performing TDRs	$7,437	$9,118
Nonperforming TDRs	1,926	14,507
Total TDRs	$9,363	$23,625

Note 5 — Reserve for Loan and Lease Losses

The following table shows the changes in the reserve for loan and lease losses, segregated by class, for each of the three years ended December 31.

(Dollars in thousands)	Commercial and agricultural	Auto and light truck	Medium and heavy duty truck	Aircraft financing	Construction equipment financing	Commercial real estate	Residential real estate	Consumer	Total
2015									
Balance, beginning of year	$11,760	$10,326	$4,500	$32,234	$7,008	$13,270	$4,102	$1,868	$85,068
Charge-offs	3,489	24	—	244	—	—	141	812	4,710
Recoveries	851	380	28	802	434	2,807	11	281	5,594
Net charge-offs (recoveries)	2,638	(356)	(28)	(558)	(434)	(2,807)	130	531	(884)
Provision (recovery of provision)	6,334	(1,413)	171	(419)	150	(2,315)	(590)	242	2,160
Balance, end of year	$15,456	$9,269	$4,699	$32,373	$7,592	$13,762	$3,382	$1,579	$88,112
2014									
Balance, beginning of year	$11,515	$9,657	$4,212	$34,037	$5,972	$12,406	$4,093	$1,613	$83,505
Charge-offs	5,007	42	—	—	4	99	46	833	6,031
Recoveries	929	1,283	142	240	525	347	97	298	3,861
Net charge-offs (recoveries)	4,078	(1,241)	(142)	(240)	(521)	(248)	(51)	535	2,170
Provision (recovery of provision)	4,323	(572)	146	(2,043)	515	616	(42)	790	3,733
Balance, end of year	$11,760	$10,326	$4,500	$32,234	$7,008	$13,270	$4,102	$1,868	$85,068
2013									
Balance, beginning of year	$12,326	$8,864	$3,721	$34,205	$5,390	$13,778	$3,652	$1,375	$83,311
Charge-offs	538	226	57	1,308	88	170	316	1,125	3,828
Recoveries	468	139	462	884	323	627	14	333	3,250
Net charge-offs (recoveries)	70	87	(405)	424	(235)	(457)	302	792	578
Provision (recovery of provision)	(741)	880	86	256	347	(1,829)	743	1,030	772
Balance, end of year	$11,515	$9,657	$4,212	$34,037	$5,972	$12,406	$4,093	$1,613	$83,505

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

(Dollars in thousands)	Commercial and agricultural	Auto and light truck	Medium and heavy duty truck	Aircraft financing	Construction equipment financing	Commercial real estate	Residential real estate	Consumer	Total
December 31, 2015									
Reserve for loan and lease losses									
Ending balance, individually evaluated for impairment	$649	$—	$—	$—	$—	$—	$148	$—	$797
Ending balance, collectively evaluated for impairment	14,807	9,269	4,699	32,373	7,592	13,762	3,234	1,579	87,315
Total reserve for loan and lease losses	$15,456	$9,269	$4,699	$32,373	$7,592	$13,762	$3,382	$1,579	$88,112
Recorded investment in loans									
Ending balance, individually evaluated for impairment	$3,900	$—	$—	$4,384	$539	$8,494	$366	$—	$17,683
Ending balance, collectively evaluated for impairment	740,849	425,236	278,254	773,628	455,026	691,774	463,763	148,479	3,977,009
Total recorded investment in loans	$744,749	$425,236	$278,254	$778,012	$455,565	$700,268	$464,129	$148,479	$3,994,692
December 31, 2014									
Reserve for loan and lease losses									
Ending balance, individually evaluated for impairment	$5	$—	$—	$—	$—	$80	$156	$—	$241
Ending balance, collectively evaluated for impairment	11,755	10,326	4,500	32,234	7,008	13,190	3,946	1,868	84,827
Total reserve for loan and lease losses	$11,760	$10,326	$4,500	$32,234	$7,008	$13,270	$4,102	$1,868	$85,068
Recorded investment in loans									
Ending balance, individually evaluated for impairment	$14,542	$—	$—	$12,740	$746	$12,505	$373	$—	$40,906
Ending balance, collectively evaluated for impairment	696,216	397,902	247,153	714,925	399,194	604,082	445,386	142,810	3,647,668
Total recorded investment in loans	$710,758	$397,902	$247,153	$727,665	$399,940	$616,587	$445,759	$142,810	$3,688,574

Note 6 — Operating Leases

Operating lease equipment at December 31, 2015 and 2014 was $110.37 million and $74.14 million, respectively, net of accumulated depreciation of $33.63 million and $29.62 million, respectively.

The minimum future lease rental payments due from clients on operating lease equipment at December 31, 2015, totaled $81.65 million, of which $22.08 million is due in 2016, $19.35 million in 2017, $16.02 million in 2018, $11.52 million in 2019, $11.01 million in 2020, and $1.67 million thereafter. Depreciation expense related to operating lease equipment for the years ended December 31, 2015, 2014 and 2013 was $18.28 million, $13.89 million and $13.06 million, respectively.

Note 7 — Premises and Equipment

The following table shows premises and equipment as of December 31.

(Dollars in thousands)	2015	2014
Land	$16,105	$15,785
Buildings and improvements	53,917	51,412
Furniture and equipment	38,942	36,737
Total premises and equipment	108,964	103,934
Accumulated depreciation and amortization	(55,773)	(53,606)
Net premises and equipment	$53,191	$50,328

Depreciation and amortization of properties and equipment totaled $4.78 million in 2015, $4.75 million in 2014, and $4.73 million in 2013.

During 2015 and 2014, the Company recorded long-lived asset impairment charges totaling $150,000 and $275,000, respectively. The impairment charges were recorded as a result of appraisals on buildings and were recognized in Other Expense on the Statements of Income.

Note 8 — Mortgage Servicing Rights

The unpaid principal balance of residential mortgage loans serviced for third parties was $798.51 million at December 31, 2015, compared to $825.17 million at December 31, 2014, and $839.26 million at December 31, 2013.

Table of Contents

Amortization expense on MSRs is expected to total $0.75 million, $0.63 million, $0.53 million, $0.45 million, and $0.38 million in 2016, 2017, 2018, 2019 and 2020, respectively. Projected amortization excludes the impact of future asset additions or disposals.

The following table shows changes in the carrying value of MSRs and the associated valuation allowance.

(Dollars in thousands)	2015	2014
Mortgage servicing rights:		
Balance at beginning of year	$4,733	$4,844
Additions	1,299	1,167
Amortization	(1,424)	(1,278)
Sales	—	—
Carrying value before valuation allowance at end of year	4,608	4,733
Valuation allowance:		
Balance at beginning of year	—	—
Impairment recoveries	—	—
Balance at end of year	$—	$—
Net carrying value of mortgage servicing rights at end of year	$4,608	$4,733
Fair value of mortgage servicing rights at end of year	$7,246	$6,979

At December 31, 2015, the fair value of MSRs exceeded the carrying value reported in the Statements of Financial Condition by $2.64 million. This difference represents increases in the fair value of certain MSRs that could not be recorded above cost basis.

Funds held in trust at 1st Source for the payment of principal, interest, taxes and insurance premiums applicable to mortgage loans being serviced for others, were approximately $12.22 million and $14.74 million at December 31, 2015 and December 31, 2014, respectively. Mortgage loan contractual servicing fees, including late fees and ancillary income, were $2.84 million, $3.01 million, and $3.21 million for 2015, 2014, and 2013, respectively. Mortgage loan contractual servicing fees are included in Mortgage Banking Income on the Statements of Income.

Note 9 — Intangible Assets and Goodwill

At December 31, 2015, intangible assets consisted of goodwill of $83.68 million and other intangible assets of $1.00 million, which was net of accumulated amortization of $8.57 million. At December 31, 2014, intangible assets consisted of goodwill of $83.68 million and other intangible assets of $1.69 million, which was net of accumulated amortization of $8.13 million. Intangible asset amortization was $0.69 million, $0.97 million, and $1.16 million for 2015, 2014, and 2013, respectively. Amortization on other intangible assets is expected to total $0.57 million, $0.36 million, $0.06 million, and $0.01 million in 2016, 2017, 2018, and 2019, respectively.

The following table shows a summary of core deposit intangible and other intangible assets as of December 31.

(Dollars in thousands)	2015	2014
Core deposit intangibles:		
Gross carrying amount	$9,566	$9,566
Less: accumulated amortization	(8,569)	(7,888)
Net carrying amount	$997	$1,678
Other intangibles:		
Gross carrying amount	$—	$254
Less: accumulated amortization	—	(241)
Net carrying amount	$—	$13

Table of Contents

Note 10 — Deposits

The aggregate amount of certificates of deposit of $250,000 or more and other time deposits of $250,000 or more outstanding at December 31, 2015 and 2014 was $422.38 million and $295.42 million, respectively.

The following table shows the amount of certificates of deposit of $250,000 or more and other time deposits of $250,000 or more outstanding at December 31, 2015, by time remaining until maturity.

(Dollars in thousands)	
Under 3 months	$66,085
4 – 6 months	68,413
7 – 12 months	64,224
Over 12 months	223,653
Total	$422,375

The following table shows scheduled maturities of time deposits, including both private and public funds, at December 31, 2015.

(Dollars in thousands)	
2016	$510,796
2017	225,880
2018	178,987
2019	145,784
2020	74,935
Thereafter	4,362
Total	$1,140,744

Note 11 — Borrowed Funds and Mandatorily Redeemable Securities

The following table shows the details of long-term debt and mandatorily redeemable securities as of December 31, 2015 and 2014.

(Dollars in thousands)	2015	2014
Federal Home Loan Bank borrowings (1.10% – 6.54%)	$38,044	$38,582
Mandatorily redeemable securities	17,388	15,678
Other long-term debt	1,947	1,972
Total long-term debt and mandatorily redeemable securities	$57,379	$56,232

Annual maturities of long-term debt outstanding at December 31, 2015, for the next five years and thereafter beginning in 2016, are as follows (in thousands): $6,296; $26,351; $917; $826; $721; and $22,268.

At December 31, 2015, the Federal Home Loan Bank borrowings represented a source of funding for community economic development activities, agricultural loans and general funding for the bank and consisted of 18 fixed rate notes with maturities ranging from 2016 to 2024. These notes were collateralized by $47.56 million of certain real estate loans.

Mandatorily redeemable securities as of December 31, 2015 and 2014, of $17.39 million and $15.68 million, respectively reflected the “book value” shares under the 1st Source Executive Incentive Plan. See Note 16 - Employee Stock Benefit Plans for additional information. Dividends paid on these shares and changes in book value per share are recorded as other interest expense. Total interest expense recorded for 2015, 2014, and 2013 was $1.37 million, $1.47 million, and $1.00 million, respectively.

The following table shows the details of short-term borrowings as of December 31, 2015 and 2014.

	2015		2014	
(Dollars in thousands)	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Federal funds purchased	$—	— %	$10,500	0.50 %
Security repurchase agreements	130,662	0.29	128,343	0.10
Commercial paper	7,295	0.28	11,778	0.27
Other short-term borrowings	95,272	0.38	95,201	0.29
Total short-term borrowings	$233,229		$245,822	

Table of Contents

Note 12 — Subordinated Notes

The Company sponsors one trust, 1st Source Master Trust (Capital Trust) of which 100% of the common equity is owned by the Company. The Capital Trust was formed in 2007 for the purpose of issuing corporation-obligated mandatorily redeemable capital securities (the capital securities) to third-party investors and investing the proceeds from the sale of the capital securities solely in junior subordinated debenture securities of the Company (the subordinated notes). The subordinated notes held by the Capital Trust are the sole assets of the Capital Trust. The Capital Trust qualifies as a variable interest entity for which the Company is not the primary beneficiary and therefore reported in the financial statements as an unconsolidated subsidiary. The junior subordinated debentures are reflected as subordinated notes in the Statements of Financial Condition with the corresponding interest distributions reflected as Interest Expense in the Statements of Income. The common shares issued by the Capital Trust are included in Other Assets in the Statements of Financial Condition.

Distributions on the capital securities issued by the Capital Trust are payable quarterly at a rate per annum equal to the interest rate being earned by the Capital Trust on the subordinated notes held by the Capital Trust. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the subordinated notes. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of each of the guarantees. The capital securities held by the Capital Trust qualify as Tier 1 capital under Federal Reserve Board guidelines.

The following table shows subordinated notes at December 31, 2015.

(Dollars in thousands)	Amount of Subordinated Notes	Interest Rate		Maturity Date
June 2007 issuance (1)	$41,238	7.22	%	6/15/2037
August 2007 issuance (2)	17,526	7.10	%	9/15/2037
Total	$58,764			

(1) Fixed rate through life of debt.

(2) Fixed rate through September 15, 2017 then LIBOR +1.48% through remaining life of debt.

Note 13 — Earnings Per Share

Earnings per common share is computed using the two-class method. Basic earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include non-vested restricted stock awards. Non-vested restricted stock awards are considered participating securities to the extent the holders of these securities receive non-forfeitable dividends at the same rate as holders of common stock. Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the dilutive effect of stock compensation using the treasury stock method.

Stock options, where the exercise price was greater than the average market price of the common shares, were excluded from the computation of diluted earnings per common share because the result would have been antidilutive. No stock options were considered antidilutive as of December 31, 2015, 2014 and 2013.

The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted earnings per common share for the three years ending December 31.

(Dollars in thousands - except per share amounts)	2015	2014	2013
Distributed earnings allocated to common stock	$17,582	$17,091	$16,563
Undistributed earnings allocated to common stock	39,336	40,249	37,673
Net earnings allocated to common stock	56,918	57,340	54,236
Net earnings allocated to participating securities	568	729	722
Net income allocated to common stock and participating securities	$57,486	$58,069	$54,958
Weighted average shares outstanding for basic earnings per common share*	26,173,351	26,434,769	26,779,086

Dilutive effect of stock compensation*	—	—	644
Weighted average shares outstanding for diluted earnings per common share*	26,173,351	26,434,769	26,779,730
Basic earnings per common share*	$2.17	$2.17	$2.03
Diluted earnings per common share*	$2.17	$2.17	$2.03

*Outstanding shares and per common share figures have been adjusted for 10% stock dividend declared July 22, 2015 and issued on August 14, 2015.

Table of Contents

Note 14 — Accumulated Other Comprehensive Income

The following table presents reclassifications out of accumulated other comprehensive income related to unrealized gains and losses on available-for-sale securities for the two years ending December 31.

(Dollars in thousands)	2015	2014	Affected Line Item in the Statements of Income
Realized gains included in net income	$4	$963	Gains on investment securities available-for-sale
	4	963	Income before income taxes
Tax effect	(2)	(361)	Income tax expense
Net of tax	$2	$602	Net income

Note 15 — Employee Benefit Plans

The 1st Source Corporation Employee Stock Ownership and Profit Sharing Plan (as amended, the "Plan") includes an employee stock ownership component, which is designed to invest in and hold 1st Source common stock, and a 401(k) plan component, which holds all Plan assets not invested in 1st Source common stock. The Plan encourages diversification of investments with opportunities to change investment elections and contribution levels.

Employees are eligible to participate in the Plan the first of the month following 90 days of employment. The Company matches dollar for dollar on the first 4% of deferred compensation, plus 50 cents on the dollar of the next 2% deferrals. The Company will also contribute to the Plan an amount designated as a fixed 2% employer contribution. The amount of fixed contribution is equal to two percent of the participant's eligible compensation. Additionally, each year the Company may, in its sole discretion, make a discretionary profit sharing contribution. As of December 31, 2015 and 2014, there were 1,356,715 and 1,308,041 shares, respectively, of 1st Source Corporation common stock held in relation to employee benefit plans.

The Company contributions are allocated among the participants on the basis of compensation. Each participant's account is credited with cash and/or shares of 1st Source common stock based on that participant's compensation earned during the year. After completing 5 years of service in which they worked at least 1,000 hours per year, a participant will be completely vested in the Company's contribution. An employee is always 100% vested in their deferral. Plan participants are entitled to receive distributions from their Plan accounts upon termination of service, retirement, or death.

Contribution expense for the years ended December 31, 2015, 2014, and 2013, amounted to $4.57 million, $4.32 million, and $4.38 million, respectively.

In addition to the 1st Source Corporation Employee Stock Ownership and Profit Sharing Plan, the Company provides a limited health care and life insurance benefit for some of its retired employees. Effective March 31, 2009, the Company amended the plan so that no new retirees would be covered by the plan. The amendment will have no effect on the coverage for retirees covered at the time of the amendment. Prior to amendment, all full-time employees became eligible for these retiree benefits upon reaching age 55 with 20 years of credited service. The retiree medical plan pays a stated percentage of eligible medical expenses reduced by any deductibles and payments made by government programs and other group coverage. The lifetime maximum benefit payable under the medical plan is $15,000 and for life insurance is $3,000.

The Company's net periodic post retirement benefit (recovery) cost recognized in the Statements of Income for the years ended December 31, 2015, 2014 and 2013, amounted to $(0.02) million, $(0.05) million, and $(0.04) million, respectively. The accrued post retirement benefit cost was not material at December 31, 2015, 2014, and 2013.

Note 16 — Stock Based Compensation

As of December 31, 2015, the Company had four active stock-based employee compensation plans. These plans include three executive stock award plans, the Executive Incentive Plan (EIP), the Restricted Stock Award Plan (RSAP), the Strategic Deployment Incentive Plan (SDP) - formerly known as the 1998 Performance Compensation Plan; and the Employee Stock Purchase Plan (ESPP). The 2011 Stock Option Plan was approved by the shareholders on April 21, 2011 but the Company had not made any grants through December 31, 2015. These stock-based employee compensation plans were established to help retain and motivate key employees. All of the plans have been approved by the shareholders of 1st Source Corporation. The Executive Compensation and Human Resources

Committee (the “Committee”) of the 1st Source Corporation Board of Directors has sole authority to select the employees, establish the awards to be issued, and approve the terms and conditions of each award under the stock-based compensation plans.

Stock-based compensation to employees is recognized as compensation cost in the Statements of Income based on their fair values on the measurement date, which, for 1st Source, is the date of grant. Stock-based compensation expense is recognized ratably over the requisite service period for all awards. The total fair value of share awards vested was $4.37 million during 2015, $3.66 million in 2014, and $1.97 million in 2013.

Table of Contents

The following table shows the combined summary of activity regarding active stock option and stock award plans.

		Non-Vested Stock Awards Outstanding*		Stock Options Outstanding*	
	Shares Available for Grant*	Number of Shares	Weighted-Average Grant-Date Fair Value	Number of Shares	Weighted-Average Exercise Price
Balance, January 1, 2013	2,525,382	476,526	$ 18.31	8,250	$ 10.95
Shares authorized - 2013 EIP	68,167	—	—	—	—
Shares authorized - Strategic Deployment Incentive Plan	2,211	—	—	—	—
Granted	(98,197)	98,197	22.01	—	—
Stock options exercised	—	—	—	(8,250)	10.95
Stock awards vested	—	(94,903)	17.83	—	—
Forfeited	6,206	(11,830)	18.83	—	—
Canceled	—	—	—	—	—
Balance, December 31, 2013	2,503,769	467,990	19.17	—	—
Shares authorized - 2014 EIP	76,230	—	—	—	—
Granted	(123,154)	123,154	23.56	—	—
Stock awards vested	—	(144,941)	18.57	—	—
Forfeited	3,363	(6,168)	18.97	—	—
Canceled	—	—	—	—	—
Balance, December 31, 2014	2,460,208	440,035	20.60	—	—
Shares authorized - 2015 EIP	70,202	—	—	—	—
Granted	(81,591)	81,591	24.44	—	—
Stock awards vested	—	(159,381)	19.51	—	—
Forfeited	1,980	(3,384)	23.85	—	—
Canceled	—	—	—	—	—
Balance, December 31, 2015	2,450,799	358,861	$ 21.93	—	$ —

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

Stock Option Plans — Incentive stock option plans include the 2001 Stock Option Plan (the “2001 Plan”) and the 2011 Stock Option Plan (the “2011 Plan”). The 2001 Plan was terminated, except for outstanding options, after the 2011 Plan was approved by the shareholders. During 2013, all remaining shares available for issuance upon exercise from previous grants under the 2001 Plan were exercised. No additional grants will be made under the 2001 Plan. There were 2,200,000 shares available for issuance under the 2011 Plan.

Each award from all plans is evidenced by an award agreement that specifies the option price, the duration of the option, the number of shares to which the option pertains, and such other provisions as the Committee determines. The option price is equal to the fair market value of a share of 1st Source Corporation’s common stock on the date of grant. Options granted expire at such time as the Committee determines at the date of grant and in no event does the exercise period exceed a maximum of ten years. Upon merger, consolidation, or other corporate consolidation in which 1st Source Corporation is not the surviving corporation, as defined in the plans, all outstanding options immediately vest. There were zero stock options exercised during 2015 and 2014 and 8,250 stock options exercised during 2013. All shares issued in connection with stock option exercises and non-vested stock awards are issued from available treasury stock.

No stock-based compensation expense related to stock options was recognized in 2015, 2014 or 2013.

The fair value of each option on the date of grant is estimated using the Black-Scholes option pricing model. Expected volatility is based on the historical volatility estimated over a period equal to the expected life of the options. In estimating the fair value of stock options under the Black-Scholes valuation model, separate groups of employees that have similar historical exercise behavior are considered separately. The expected life of the options granted is derived based on past experience and represents the period of time that options granted are expected to be outstanding.

Table of Contents

Stock Award Plans — Incentive stock award plans include the EIP, the SDP and the RSAP. The EIP is administered by the Committee. Awards under the EIP and SDP include “book value” shares and “market value” shares of common stock. These shares are awarded annually based on weighted performance criteria and generally vest over a period of five years. The EIP book value shares may only be sold to 1st Source and such sale is mandatory in the event of death, retirement, disability, or termination of employment. The RSAP is designed for key employees. Awards under the RSAP are made to employees recommended by the Chief Executive Officer and approved by the Committee. Shares granted under the RSAP vest over two to ten years and vesting is based upon meeting certain various criteria, including continued employment with 1st Source.

Stock-based compensation expense relating to the EIP, SDP and RSAP totaled $3.84 million in 2015, $3.18 million in 2014, and $2.90 million in 2013. The total income tax benefit recognized in the accompanying Statements of Income related to stock-based compensation was $1.45 million in 2015, $1.20 million in 2014, and $1.10 million in 2013. Unrecognized stock-based compensation expense related to non-vested stock awards (EIP/SDP/RSAP) was $5.04 million at December 31, 2015. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 3.21 years.

The fair value of non-vested stock awards for the purposes of recognizing stock-based compensation expense is market price of the stock on the measurement date, which, for the Company’s purposes is the date of the award.

Employee Stock Purchase Plan — The Company offers an ESPP for substantially all employees with at least two years of service on the effective date of an offering under the plan. Eligible employees may elect to purchase any dollar amount of stock, so long as such amount does not exceed 25% of their base rate of pay and the aggregate stock accrual rate for all offerings does not exceed $25,000 in any calendar year. The purchase price for shares offered is the lower of the closing market bid price for the offering date or the average market bid price for the five business days preceding the offering date. The purchase price and premium/(discount) to the actual market closing price on the offering date for the 2015, 2014, and 2013 offerings were $28.80 (0.23%), $27.63 (-0.88%), and $22.11 (-1.82%), respectively. Payment for the stock is made through payroll deductions over the offering period, and employees may discontinue the deductions at any time and exercise the option or take the funds out of the program. The most recent offering began June 1, 2015 and runs through May 31, 2017, with $172,380 in stock value to be purchased at $28.80 per share.

All share and per share data in the preceding sections give retrospective recognition to a 10% stock dividend declared July 22, 2015 and issued on August 14, 2015.

Note 17 — Income Taxes

The following table shows the composition of income tax expense.

Year Ended December 31 (Dollars in thousands)	2015	2014	2013
Current:			
Federal	$26,092	$20,999	$28,634
State	3,365	1,034	2,298
Total current	29,457	22,033	30,932
Deferred:			
Federal	1,577	4,022	(2,337)
State	43	319	390
Total deferred	1,620	4,341	(1,947)
Total provision	$31,077	$26,374	$28,985

The following table shows the reasons for the difference between income tax expense and the amount computed by applying the statutory federal income tax rate (35%) to income before income taxes.

	2015		2014		2013	
Year Ended December 31 (Dollars in thousands)	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Statutory federal income tax	$30,997	35.0 %	$29,555	35.0 %	$29,380	35.0 %

(Decrease) increase in income taxes resulting from:						
Tax-exempt interest income	(1,152)	(1.3)	(1,236)	(1.5)	(1,219)	(1.5)
State taxes, net of federal income tax benefit	2,215	2.5	2,300	2.7	1,747	2.1
Reduction in uncertain tax positions	—	—	(3,300)	(3.9)	—	—
Other	(983)	(1.1)	(945)	(1.1)	(923)	(1.1)
Total	$31,077	35.1 %	$26,374	31.2 %	$28,985	34.5 %

61

Table of Contents

The tax expense (benefit) related to gains (losses) on investment securities available-for-sale for the years 2015, 2014, and 2013 was approximately $2,000, $361,000, and $(63,000), respectively.

The following table shows the composition of deferred tax assets and liabilities as of December 31, 2015 and 2014.

(Dollars in thousands)	2015	2014
Deferred tax assets:		
Reserve for loan and lease losses	$34,410	$33,088
Accruals for employee benefits	3,816	3,346
Other	905	1,079
Total deferred tax assets	39,131	37,513
Deferred tax liabilities:		
Differing depreciable bases in premises and leased equipment	27,274	24,506
Net unrealized gains on securities available-for-sale	3,940	5,654
Differing bases in assets related to acquisitions	5,738	5,160
Mortgage servicing	1,630	1,644
Capitalized loan costs	1,454	1,437
Prepaid expenses	1,055	1,035
Other	312	443
Total deferred tax liabilities	41,403	39,879
Net deferred tax liability	$(2,272)	$(2,366)

No valuation allowance for deferred tax assets was recorded at December 31, 2015 and 2014 as the Company believes it is more likely than not that all of the deferred tax assets will be realized.

The following table shows a reconciliation of the beginning and ending amounts of unrecognized tax benefits.

(Dollars in thousands)	2015	2014	2013
Balance, beginning of year	$—	$4,611	$4,068
Additions based on tax positions related to the current year	380	66	484
Additions for tax positions of prior years	—	592	1,118
Reductions for tax positions of prior years	—	(553)	—
Reductions due to lapse in statute of limitations	—	(1,650)	(1,059)
Settlements	—	(3,066)	—
Balance, end of year	$380	$—	$4,611

The total amount of unrecognized tax benefits that would affect the effective tax rate if recognized was $0.25 million at December 31, 2015, zero at December 31, 2014, and $2.62 million at December 31, 2013. Interest and penalties are recognized through the income tax provision. For 2015, the Company recognized zero interest, net of tax effect, and penalties, and for the years 2014 and 2013, the Company recognized approximately $(0.69) million and $0.14 million in interest, net of tax effect, and penalties, respectively. There were no accrued interest and penalties at December 31, 2015 and December 31, 2014, respectively and interest and penalties of approximately $0.69 million were accrued at 2013.

Tax years that remain open and subject to audit include the federal 2012-2015 years and the Indiana 2013-2015 years. Additionally, during 2014 the Company reached a state tax settlement for the 2010-2013 years and as a result recorded a reduction of unrecognized tax benefits in the amount of $2.93 million that affected the effective tax rate and increased earnings in the amount of $2.12 million. The Company does not anticipate a significant change in the amount of uncertain tax positions within the next 12 months.

Note 18 — Contingent Liabilities, Commitments, and Financial Instruments with Off-Balance-Sheet Risk

Contingent Liabilities —1st Source and its subsidiaries are defendants in various legal proceedings arising in the normal course of business. In the opinion of management, based upon present information including the advice of legal counsel, the ultimate resolution of these proceedings will not have a material effect on the Company’s consolidated financial position or results of operations.

Table of Contents

1st Source Bank sells residential mortgage loans to Fannie Mae as well as FHA-insured and VA-guaranteed loans in Ginnie Mae mortgage-backed securities. Additionally, the Bank has sold loans on a service released basis to various other financial institutions in recent years. The agreements under which the Bank sells these mortgage loans contain various representations and warranties regarding the acceptability of loans for purchase. On occasion, the Bank may be required to indemnify the loan purchaser for credit losses on loans that were later deemed ineligible for purchase or may be required to repurchase a loan. Both circumstances are collectively referred to as "repurchases."

The Company's liability for repurchases, included in Accrued Expenses and Other Liabilities on the Statements of Financial Condition, was $0.98 million and $1.72 million as of December 31, 2015 and 2014, respectively. The mortgage repurchase liability represents the Company's best estimate of the loss that it may incur. The estimate is based on specific loan repurchase requests and a historical loss ratio with respect to origination dollar volume. Because the level of mortgage loan repurchase losses are dependent on economic factors, investor demand strategies and other external conditions that may change over the life of the underlying loans, the level of liability for mortgage loan repurchase losses is difficult to estimate and requires considerable management judgment.

Commitments — 1st Source and its subsidiaries are obligated under operating leases for certain office premises and equipment. Future minimum rental commitments for all noncancellable operating leases total approximately, $3.49 million in 2016, $3.07 million in 2017, $2.66 million in 2018, $2.45 million in 2019, $2.22 million in 2020, and $2.11 million, thereafter. As of December 31, 2015, future minimum rentals to be received under noncancellable subleases totaled $1.92 million.

The following table shows rental expense of office premises and equipment and related sublease income.

Year Ended December 31 (Dollars in thousands)	2015	2014	2013
Gross rental expense	$3,889	$3,799	$3,875
Sublease rental income	(914)	(878)	(910)
Net rental expense	$2,975	$2,921	$2,965

Financial Instruments with Off-Balance-Sheet Risk —To meet the financing needs of our clients, 1st Source and its subsidiaries are parties to financial instruments with off-balance-sheet risk in the normal course of business. These off-balance-sheet financial instruments include commitments to originate and sell loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition.

Financial instruments, whose contract amounts represent credit risk as of December 31, were as follows:

(Dollars in thousands)	2015	2014
Amounts of commitments:		
Loan commitments to extend credit	$829,509	$733,870
Standby letters of credit	$37,984	$26,939

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for loan commitments and standby letters of credit is represented by the dollar amount of those instruments. The Company uses the same credit policies and collateral requirements in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company grants mortgage loan commitments to borrowers subject to normal loan underwriting standards. The interest rate risk associated with these loan commitments is managed by entering into contracts for future deliveries of loans.

Standby letters of credit are conditional commitments issued to guarantee the performance of a client to a third party. The credit risk involved in and collateral obtained when issuing standby letters of credit are essentially the same as those involved in extending loan commitments to clients. Standby letters of credit generally have terms ranging from six months to one year.

Note 19 — Derivative Financial Instruments

Commitments to originate residential mortgage loans held for sale and forward commitments to sell residential mortgage loans are considered derivative instruments. See Note 18 for further information.

Table of Contents

The Company has certain interest rate derivative positions that are not designated as hedging instruments. Derivative assets and liabilities are recorded at fair value on the Statement of Financial Condition and do not take into account the effects of master netting agreements. Master netting agreements allow the Company to settle all derivative contracts held with a single counterparty on a net basis, and to offset net derivative positions with related collateral, where applicable. These derivative positions relate to transactions in which the Company enters into an interest rate swap with a client while at the same time entering into an offsetting interest rate swap with another financial institution. In connection with each transaction, the Company agrees to pay interest to the client on a notional amount at a variable interest rate and receive interest from the client on the same notional amount at a fixed interest rate. At the same time, the Company agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the client to effectively convert a variable rate loan to a fixed rate. Because the terms of the swaps with the customers and the other financial institution offset each other, with the only difference being counterparty credit risk, changes in the fair value of the underlying derivative contracts are not materially different and do not significantly impact the Company’s results of operations.
The following table shows the amounts of non-hedging derivative financial instruments at December 31, 2015 and 2014.

		Asset derivatives		Liability derivatives	
(Dollars in thousands)	Notional or contractual amount	Statement of Financial Condition classification	Fair value	Statement of Financial Condition classification	Fair value
Interest rate swap contracts	$554,083	Other assets	$9,859	Other liabilities	$10,044
Loan commitments	12,440	Mortgages held for sale	47	N/A	—
Forward contracts - mortgage loan	16,416	Mortgages held for sale	13	N/A	—
Total - December 31, 2015	$582,939		$9,919		$10,044
Interest rate swap contracts	$459,508	Other assets	$9,125	Other liabilities	$9,302
Loan commitments	11,109	Mortgages held for sale	2	N/A	—
Forward contracts - mortgage loan	19,800	N/A	—	Mortgages held for sale	142
Total - December 31, 2014	$490,417		$9,127		$9,444

The following table shows the amounts included in the Statements of Income for non-hedging derivative financial instruments at December 31, 2015, 2014 and 2013.

		Gain (loss)		
(Dollars in thousands)	Statement of Income classification	2015	2014	2013
Interest rate swap contracts	Other expense	$(8)	$16	$124
Interest rate swap contracts	Other income	1,045	357	716
Loan commitments	Mortgage banking income	45	(10)	(208)
Forward contracts - mortgage loan	Mortgage banking income	155	(263)	154
Forward contracts - foreign exchange	Other income	—	79	(7)
Total		$1,237	$179	$779

The following table shows the offsetting of financial assets and derivative assets at December 31, 2015 and 2014.

(Dollars in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Condition	Net Amounts of Assets Presented in the Statement of Financial Condition	Gross Amounts Not Offset in the Statement of Financial Condition		
				Financial Instruments	Cash Collateral Received	Net Amount
December 31, 2015						
Interest rate swaps	$ 10,016	$ 157	$ 9,859	$—	$—	$ 9,859
December 31, 2014						
Interest rate swaps	$ 9,492	$ 367	$ 9,125	$—	$—	$ 9,125

Table of Contents

The following table shows the offsetting of financial liabilities and derivative liabilities at December 31, 2015 and 2014.

(Dollars in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Condition	Net Amounts of Liabilities Presented in the Statement of Financial Condition	Gross Amounts Not Offset in the Statement of Financial Condition		
				Financial Instruments	Cash Collateral Pledged	Net Amount
December 31, 2015						
Interest rate swaps	$10,201	$157	$10,044	$—	$9,833	$211
Repurchase agreements	130,662	—	130,662	130,662	—	—
Total	$140,863	$157	$140,706	$130,662	$9,833	$211
December 31, 2014						
Interest rate swaps	$9,669	$367	$9,302	$—	$9,018	$284
Repurchase agreements	128,343	—	128,343	128,343	—	—
Total	$138,012	$367	$137,645	$128,343	$9,018	$284

If a default in performance of any obligation of a repurchase agreement occurs, each party will set-off property held in respect of transactions against obligations owing in respect of any other transactions. At December 31, 2015 and December 31, 2014, repurchase agreements had a remaining contractual maturity of $128.88 million and $107.63 million in overnight and $1.78 million and $20.71 million in up to 30 days, respectively and were collateralized by U.S. Treasury and Federal agencies securities.

Note 20 — Regulatory Matters

The Company is subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classification are subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total capital, Tier 1 capital, and common equity Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. The Company believes that it meets all capital adequacy requirements to which it is subject.

The most recent notification from the Federal bank regulators categorized 1st Source Bank, the largest of its subsidiaries, as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Bank must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that the Company believes will have changed the institution's category.

Table of Contents

As discussed in Note 12, the capital securities held by the Capital Trusts qualify as Tier 1 capital under Federal Reserve Board guidelines. The following table shows the actual and required capital amounts and ratios for 1st Source Corporation and 1st Source Bank as of December 31, 2015 and 2014.

	Actual			Minimum Capital Adequacy			To Be Well Capitalized Under Prompt Corrective Action Provisions		
(Dollars in thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio	
2015									
Total Capital (to Risk-Weighted Assets):									
1st Source Corporation	$676,007	14.97	%	$361,267	8.00	%	$451,584	10.00	%
1st Source Bank	636,592	14.13	%	360,402	8.00	%	450,502	10.00	%
Tier 1 Capital (to Risk-Weighted Assets):									
1st Source Corporation	616,577	13.65	%	270,951	6.00	%	361,267	8.00	%
1st Source Bank	579,833	12.87	%	270,301	6.00	%	360,402	8.00	%
Common Equity Tier 1 Capital (to Risk-Weighted Assets):									
1st Source Corporation	559,577	12.39	%	203,213	4.50	%	293,530	6.50	%
1st Source Bank	579,833	12.87	%	202,726	4.50	%	292,826	6.50	%
Tier 1 Capital (to Average Assets):									
1st Source Corporation	616,577	12.21	%	201,921	4.00	%	252,401	5.00	%
1st Source Bank	579,833	11.50	%	201,701	4.00	%	252,126	5.00	%
2014									
Total Capital (to Risk-Weighted Assets):									
1st Source Corporation	$629,023	15.89	%	$316,704	8.00	%	$395,880	10.00	%
1st Source Bank	598,038	15.15	%	315,886	8.00	%	394,857	10.00	%
Tier 1 Capital (to Risk-Weighted Assets):									
1st Source Corporation	576,692	14.57	%	158,352	4.00	%	237,528	6.00	%
1st Source Bank	548,094	13.88	%	157,943	4.00	%	236,914	6.00	%
Tier 1 Capital (to Average Assets):									
1st Source Corporation	576,692	12.16	%	189,718	4.00	%	237,147	5.00	%
1st Source Bank	548,094	11.57	%	189,412	4.00	%	236,765	5.00	%

The Bank was not required to maintain noninterest bearing cash balances with the Federal Reserve Bank as of December 31, 2015 and 2014.

Dividends that may be paid by a subsidiary bank to the parent company are subject to certain legal and regulatory limitations and also may be affected by capital needs, as well as other factors.

Due to the Company’s mortgage activities, 1st Source Bank is required to maintain minimum net worth capital requirements established by various governmental agencies. 1st Source Bank’s net worth requirements are governed by the Department of Housing and Urban Development and GNMA. As of December 31, 2015, 1st Source Bank met its minimum net worth capital requirements.

Note 21 — Fair Value Measurements

The Company determines the fair values of its financial instruments based on the fair value hierarchy, which requires an entity to maximize the use of quoted prices and observable inputs and to minimize the use of unobservable inputs when measuring fair value. The Company elected fair value accounting for mortgages held for sale. The Company believes the election for mortgages held for sale (which are economically hedged with free-standing derivatives) will reduce certain timing differences and better match changes in the value of these assets with changes in the value of derivatives used as economic hedges for these assets. At December 31, 2015 and 2014, all mortgages held for sale are carried at fair value.

Table of Contents

The following table shows the differences between fair value carrying amount of mortgages held for sale measured at fair value and the aggregate unpaid principal amount the Company is contractually entitled to receive at maturity on December 31, 2015 and 2014.

(Dollars in thousands)	Fair value carrying amount	Aggregate unpaid principal	Excess of fair value carrying amount over (under) unpaid principal	
December 31, 2015				
Mortgages held for sale reported at fair value:				
Total Loans	$9,825	$9,691	$134	(1)
December 31, 2014				
Mortgages held for sale reported at fair value:				
Total Loans	$13,604	$13,526	$78	(1)

(1)The excess of fair value carrying amount over (under) unpaid principal is included in mortgage banking income and includes changes in fair value at and subsequent to funding and gains and losses on the related loan commitment prior to funding.

Financial Instruments on Recurring Basis:

The following is a description of the valuation methodologies used for financial instruments measured at fair value on a recurring basis:

Investment securities available-for-sale are valued primarily by a third party pricing agent. Prices supplied by the independent pricing agent, as well as their pricing methodologies and assumptions, are reviewed by the Company for reasonableness and to ensure such prices are aligned with market levels. In general, the Company's investment securities do not possess a complex structure that could introduce greater valuation risk. The portfolio mainly consists of traditional investments including U.S. Treasury and Federal agencies securities, federal agency mortgage pass-through securities, and general obligation and revenue municipal bonds. Pricing for such instruments is fairly generic and is easily obtained. On a quarterly basis, prices supplied by the pricing agent are validated by comparison to prices obtained from other third party sources for a material portion of the portfolio.

The valuation policy and procedures for Level 3 fair value measurements of available for sale debt securities are decided through collaboration between management of the Corporate Accounting and Funds Management departments. The changes in fair value measurement for Level 3 securities are analyzed on a periodic basis under a collaborative framework with the aforementioned departments. The methodology and variables used for input are derived from the combination of observable and unobservable inputs. The unobservable inputs are determined through internal assumptions that may vary from period to period due to external factors, such as market movement and credit rating adjustments.

Both the market and income valuation approaches are implemented using the following types of inputs:

- U.S. treasuries are priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.
- Government-sponsored agency debt securities and corporate bonds are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.
- Other government-sponsored agency securities, mortgage-backed securities and some of the actively traded REMICs and CMOs, are primarily priced using available market information including benchmark yields, prepayment speeds, spreads and volatility of similar securities.
- Other inactive government-sponsored agency securities are primarily priced using consensus pricing and dealer quotes.
- State and political subdivisions are largely grouped by characteristics, i.e., geographical data and source of revenue in trade dissemination systems. Since some securities are not traded daily and due to other grouping limitations, active

market quotes are often obtained using benchmarking for like securities. Local direct placement municipal securities, with very little market activity, are priced using an appropriate market yield curve which incorporates a credit spread assumption.

- Marketable equity (common) securities are primarily priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.

Trading account securities are priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.

Table of Contents

Mortgages held for sale and the related loan commitments and forward contracts (hedges) are valued using a market value approach and utilizing an appropriate current market yield and a loan commitment closing rate based on historical analysis.
Interest rate swap positions, both assets and liabilities, are valued by a third party pricing agent using an income approach and utilizing models that use as their basis readily observable market parameters. This valuation process considers various factors including interest rate yield curves, time value and volatility factors. Validation of third party agent valuations is accomplished by comparing those values to the Company's swap counterparty valuations.
Management believes an adjustment is required to "mid-market" valuations for derivatives tied to its performing loan portfolio to recognize the imprecision and related exposure inherent in the process of estimating expected credit losses as well as velocity of deterioration evident with systemic risks imbedded in these portfolios.
The following table shows the balance of assets and liabilities measured at fair value on a recurring basis.

(Dollars in thousands)	Level 1	Level 2	Level 3	Total
December 31, 2015				
Assets:				
Investment securities available-for-sale:				
U.S. Treasury and Federal agencies securities	$19,879	$369,790	$—	$389,669
U.S. States and political subdivisions securities	—	118,462	4,528	122,990
Mortgage-backed securities - Federal agencies	—	236,297	—	236,297
Corporate debt securities	—	34,383	—	34,383
Foreign government and other securities	—	—	809	809
Total debt securities	19,879	758,932	5,337	784,148
Marketable equity securities	7,579	—	—	7,579
Total investment securities available-for-sale	27,458	758,932	5,337	791,727
Mortgages held for sale	—	9,825	—	9,825
Accrued income and other assets (interest rate swap agreements)	—	9,859	—	9,859
Total	$27,458	$778,616	$5,337	$811,411
Liabilities:				
Accrued expenses and other liabilities (interest rate swap agreements)	$—	$10,044	$—	$10,044
Total	$—	$10,044	$—	$10,044
December 31, 2014				
Assets:				
Investment securities available-for-sale:				
U.S. Treasury and Federal agencies securities	$19,808	$353,695	$—	$373,503
U.S. States and political subdivisions securities	—	118,222	6,466	124,688
Mortgage-backed securities - Federal agencies	—	253,008	—	253,008
Corporate debt securities	—	31,932	—	31,932
Foreign government and other securities	—	—	811	811
Total debt securities	19,808	756,857	7,277	783,942
Marketable equity securities	7,176	—	—	7,176
Total investment securities available-for-sale	26,984	756,857	7,277	791,118
Trading account securities	205	—	—	205
Mortgages held for sale	—	13,604	—	13,604
Accrued income and other assets (interest rate swap agreements)	—	9,125	—	9,125
Total	$27,189	$779,586	$7,277	$814,052

Liabilities:				
Accrued expenses and other liabilities (interest rate swap agreements)	$—	$9,302	$—	$9,302
Total	$—	$9,302	$—	$9,302

68

Table of Contents

The following table shows the changes in Level 3 assets and liabilities measured at fair value on a recurring basis.

(Dollars in thousands)	U.S. States and political subdivisions securities	Foreign government and other securities	Investment securities available-for-sale
Beginning balance January 1, 2015	$6,466	$811	$7,277
Total gains or losses (realized/unrealized):			
Included in earnings	—	—	—
Included in other comprehensive income	(31)	(2)	(33)
Purchases	—	200	200
Issuances	—	—	—
Sales	—	—	—
Settlements	—	—	—
Maturities	(1,907)	(200)	(2,107)
Transfers into Level 3	—	—	—
Transfers out of Level 3	—	—	—
Ending balance December 31, 2015	$4,528	$809	$5,337
Beginning balance January 1, 2014	$5,498	$—	$5,498
Total gains or losses (realized/unrealized):			
Included in earnings	—	—	—
Included in other comprehensive income	(99)	6	(93)
Purchases	2,635	—	2,635
Issuances	—	—	—
Sales	—	—	—
Settlements	—	—	—
Maturities	(1,568)	(100)	(1,668)
Transfers into Level 3	—	905	905
Transfers out of Level 3	—	—	—
Ending balance December 31, 2014	$6,466	$811	$7,277

There were no gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at December 31, 2015 or 2014. No transfers between Level 1 and 2 occurred during 2015 or 2014. No transfers between Level 2 and 3 occurred during 2015 and one transfer between Level 2 and 3 occurred during 2014. A foreign government debt security was transferred from Level 2 to Level 3 during 2014 due to the Company's periodic review of valuation methodologies and inputs. The Company determined that the observable inputs used in determining fair value warranted a transfer to Level 3 as the unobservable inputs were deemed to be significant to the overall fair value measurement.

The following table shows the valuation methodology and unobservable inputs for Level 3 assets and liabilities measured at fair value on a recurring basis.

(Dollars in thousands)	Fair value	Valuation Methodology	Unobservable Inputs	Range of Inputs
December 31, 2015				
Investment securities available-for-sale				
Direct placement municipal securities	$4,528	Discounted cash flows	Credit spread assumption	1.27% - 2.03%
Foreign government	$809	Discounted cash flows	Market yield assumption	0.88% - 2.00%

December 31, 2014				
Investment securities available-for-sale				
Direct placement municipal securities	$6,466	Discounted cash flows	Credit spread assumption	0.99% - 2.08%
Foreign government	$811	Discounted cash flows	Market yield assumption	0.25% - 1.31%

69

Table of Contents

The sensitivity to changes in the unobservable inputs and their impact on the fair value measurement can be significant. The significant unobservable input for direct placement municipal securities are the credit spread assumptions used to determine the fair value measure. An increase (decrease) in the estimated spread assumption of the market will decrease (increase) the fair value measure of the securities. The significant unobservable input for foreign government securities are the market yield assumptions. The market yield assumption is negatively correlated to the fair value measure. An increase (decrease) in the determined market yield assumption will decrease (increase) the fair value measurement.

Financial Instruments on Non-recurring Basis:

The Company may be required, from time to time, to measure certain other financial assets at fair value on a non-recurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower of cost or market accounting or impairment charges of individual assets.

The Credit Policy Committee (CPC), a management committee, is responsible for overseeing the valuation processes and procedures for Level 3 measurements of impaired loans, other real estate and repossessions. The CPC reviews these assets on a quarterly basis to determine the accuracy of the observable inputs, generally third party appraisals, auction values, values derived from trade publications and data submitted by the borrower, and the appropriateness of the unobservable inputs, generally discounts due to current market conditions and collection issues. The CPC establishes discounts based on asset type and valuation source; deviations from the standard are documented. The discounts are reviewed periodically, annually at a minimum, to determine they remain appropriate. Consideration is given to current trends in market values for the asset categories and gain and losses on sales of similar assets. The Loan and Funds Management Committee of the Board of Directors is responsible for overseeing the CPC.

Discounts vary depending on the nature of the assets and the source of value. Aircraft are generally valued using quarterly trade publications adjusted for engine time, condition, maintenance programs, discounted by 10%. Likewise, autos are valued using current auction values, discounted by 10%; medium and heavy duty trucks are valued using trade publications and auction values, discounted by 15%. Construction equipment is generally valued using trade publications and auction values, discounted by 20%. Real estate is valued based on appraisals or evaluations, discounted by 20% at a minimum with higher discounts for property in poor condition or property with characteristics which may make it more difficult to market. Commercial loans subject to borrowing base certificates are generally discounted by 20% for receivables and 40-75% for inventory with higher discounts when monthly borrowing base certificates are not required or received.

Impaired loans and related write-downs are based on the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are reviewed quarterly and estimated using customized discounting criteria, appraisals and dealer and trade magazine quotes which are used in a market valuation approach. In accordance with fair value measurements, only impaired loans for which a reserve for loan loss has been established based on the fair value of collateral require classification in the fair value hierarchy. As a result, only a portion of the Company's impaired loans are classified in the fair value hierarchy.

Partnership investments and the adjustments to fair value primarily result from application of lower of cost or fair value accounting. The partnership investments are priced using financial statements provided by the partnerships. Quantitative unobservable inputs are not reasonably available for reporting purposes.

The Company has established MSRs valuation policies and procedures based on industry standards and to ensure valuation methodologies are consistent and verifiable. MSRs and related adjustments to fair value result from application of lower of cost or fair value accounting. For purposes of impairment, MSRs are stratified based on the predominant risk characteristics of the underlying servicing, principally by loan type. The fair value of each tranche of the servicing portfolio is estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors. Prepayment rates and discount rates are derived through a third party pricing agent. Changes in the most significant inputs, including prepayment rates and discount rates, are compared to the changes in the fair value measurements and appropriate resolution is made. A fair value analysis is also obtained from an independent third party agent and compared to the internal valuation for reasonableness. MSRs do not trade in an active, open market with readily observable prices and though sales of MSRs do occur, precise terms and conditions typically are not

readily available and the characteristics of the Company’s servicing portfolio may differ from those of any servicing portfolios that do trade.
Other real estate is based on the lower of cost or fair value of the underlying collateral less expected selling costs. Collateral values are estimated primarily using appraisals and reflect a market value approach. Fair values are reviewed quarterly and new appraisals are obtained annually. Repossessions are similarly valued.
For assets measured at fair value on a nonrecurring basis the following represents impairment charges (recoveries) recognized on these assets during the year ended December 31, 2015 and 2014, respectively: impaired loans - $0.42 million and $4.49 million; partnership investments - $(0.03) million and $0.29 million; MSRs - $0.00 million and $0.00 million; repossessions - $1.21 million and $0.73 million, and other real estate - $0.01 million and $0.17 million.

Table of Contents

The following table shows the carrying value of assets measured at fair value on a non-recurring basis.

(Dollars in thousands)	Level 1	Level 2	Level 3	Total
December 31, 2015				
Impaired loans - collateral based	$—	$—	$220	$220
Accrued income and other assets (partnership investments)	—	—	1,000	1,000
Accrued income and other assets (mortgage servicing rights)	—	—	4,608	4,608
Accrued income and other assets (repossessions)	—	—	6,927	6,927
Accrued income and other assets (other real estate)	—	—	736	736
Total	$—	$—	$13,491	$13,491
December 31, 2014				
Impaired loans - collateral based	$—	$—	$1,007	$1,007
Accrued income and other assets (partnership investments)	—	—	1,343	1,343
Accrued income and other assets (mortgage servicing rights)	—	—	4,733	4,733
Accrued income and other assets (repossessions)	—	—	5,156	5,156
Accrued income and other assets (other real estate)	—	—	1,735	1,735
Total	$—	$—	$13,974	$13,974

The following table shows the valuation methodology and unobservable inputs for Level 3 assets and liabilities measured at fair value on a non-recurring basis.

(Dollars in thousands)	Carrying Value	Fair value	Valuation Methodology	Unobservable Inputs	Range of Inputs
December 31, 2015					
Impaired loans	$ 220	$220	Collateral based measurements including appraisals, trade publications, and auction values	Discount for lack of marketability and current conditions	20%
Mortgage servicing rights	4,608	7,246	Discounted cash flows	Constant prepayment rate (CPR)	9.4% - 15.0%
				Discount rate	9.8% - 13.3%
Repossessions	6,927	7,104	Appraisals, trade publications and auction values	Discount for lack of marketability	2% - 3%
Other real estate	736	851	Appraisals	Discount for lack of marketability	8% - 35%
December 31, 2014					
Impaired loans	$ 1,007	$1,007	Collateral based measurements including appraisals, trade publications, and auction values	Discount for lack of marketability and current conditions	20% - 25%
Mortgage servicing rights	4,733	6,979	Discounted cash flows	Constant prepayment rate (CPR)	10.2% - 16.3%
				Discount rate	9.5% - 13.0%

Repossessions	5,156	5,307	Appraisals, trade publications and auction values	Discount for lack of marketability	0% - 3%
Other real estate	1,735	1,953	Appraisals	Discount for lack of marketability	5% - 38%

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring or non-recurring basis.

Table of Contents

The following table shows the fair values of the Company's financial instruments.

(Dollars in thousands)	Carrying or Contract Value	Fair Value	Level 1	Level 2	Level 3
December 31, 2015					
Assets:					
Cash and due from banks	$ 65,171	$65,171	$65,171	$—	$—
Federal funds sold and interest bearing deposits with other banks	14,550	14,550	14,550	—	—
Investment securities, available-for-sale	791,727	791,727	27,458	758,932	5,337
Other investments	21,973	21,973	21,973	—	—
Mortgages held for sale	9,825	9,825	—	9,825	—
Loans and leases, net of reserve for loan and lease losses	3,906,580	3,927,967	—	—	3,927,967
Mortgage servicing rights	4,608	7,246	—	—	7,246
Interest rate swaps	9,859	9,859	—	9,859	—
Liabilities:					
Deposits	$ 4,139,186	$4,139,649	$2,998,443	$1,141,206	$—
Short-term borrowings	233,229	233,229	134,156	99,073	—
Long-term debt and mandatorily redeemable securities	57,379	57,193	—	57,193	—
Subordinated notes	58,764	48,304	—	48,304	—
Interest rate swaps	10,044	10,044	—	10,044	—
Off-balance-sheet instruments *	—	375	—	375	—
December 31, 2014					
Assets:					
Cash and due from banks	$ 64,834	$64,834	$64,834	$—	$—
Federal funds sold and interest bearing deposits with other banks	1,356	1,356	1,356	—	—
Investment securities, available-for-sale	791,118	791,118	26,984	756,857	7,277
Other investments and trading account securities	21,006	21,006	21,006	—	—
Mortgages held for sale	13,604	13,604	—	13,604	—
Loans and leases, net of reserve for loan and lease losses	3,603,506	3,626,682	—	—	3,626,682
Mortgage servicing rights	4,733	6,979	—	—	6,979
Interest rate swaps	9,125	9,125	—	9,125	—
Liabilities:					
Deposits	$ 3,802,860	$3,803,958	$2,824,935	$979,023	$—
Short-term borrowings	245,822	245,822	123,337	122,485	—
Long-term debt and mandatorily redeemable securities	56,232	56,044	—	56,044	—
Subordinated notes	58,764	59,427	—	59,427	—
Interest rate swaps	9,302	9,302	—	9,302	—
Off-balance-sheet instruments *	—	305	—	305	—

* Represents estimated cash outflows required to currently settle the obligations at current market rates.

The methodologies for estimating fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The estimated fair value approximates carrying value for cash and due from banks, federal funds sold and interest bearing deposits with other banks, and other investments. The methodologies for other financial assets and financial liabilities are discussed below:

Loans and Leases — For variable rate loans and leases that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values of other loans and leases are estimated using discounted cash flow analyses which use interest rates currently being offered for loans and leases with similar terms to borrowers of similar credit quality.

Deposits — The fair values for all deposits other than time deposits are equal to the amounts payable on demand (the carrying value). Fair values of variable rate time deposits are equal to their carrying values. Fair values for fixed rate time deposits are estimated using discounted cash flow analyses using interest rates currently being offered for deposits with similar remaining maturities.

Table of Contents

Short-Term Borrowings — The carrying values of Federal funds purchased, securities sold under repurchase agreements, and other short-term borrowings, including the liability related to mortgage loans available for repurchase under GNMA optional repurchase programs, approximate their fair values.

Long-Term Debt and Mandatorily Redeemable Securities — The fair values of long-term debt are estimated using discounted cash flow analyses, based on our current estimated incremental borrowing rates for similar types of borrowing arrangements. The carrying values of mandatorily redeemable securities are based on our current estimated cost of redeeming these securities which approximate their fair values.

Subordinated Notes — Fair values are estimated based on calculated market prices of comparable securities.

Off-Balance-Sheet Instruments — Contract and fair values for certain of our off-balance-sheet financial instruments (guarantees) are estimated based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Limitations — Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market exists for a significant portion of our financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other such factors.

These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. These estimates are subjective in nature and require considerable judgment to interpret market data. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange, nor are they intended to represent the fair value of the Company as a whole. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of the respective balance sheet date. Although the Company is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein.

Other significant assets, such as premises and equipment, other assets, and liabilities not defined as financial instruments, are not included in the above disclosures. Also, the fair value estimates for deposits do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Note 22 — 1st Source Corporation (Parent Company Only) Financial Information

STATEMENTS OF FINANCIAL CONDITION

December 31 (Dollars in thousands)	2015	2014
ASSETS		
Cash and cash equivalents	$60,429	$51,725
Short-term investments with bank subsidiary	500	500
Investment securities, available-for-sale (amortized cost of $1,218 at December 31, 2015 and 2014)	6,855	6,240
Other investments	—	1,470
Trading account securities	—	205
Investments in:		
Bank subsidiaries	660,087	639,035
Non-bank subsidiaries	1,496	1,165
Other assets	4,668	6,356
Total assets	$734,035	$706,696
LIABILITIES AND SHAREHOLDERS' EQUITY		
Commercial paper borrowings	$8,042	$12,168
Other liabilities	3,841	3,641
Long-term debt and mandatorily redeemable securities	19,335	17,650
Subordinated notes	58,764	58,764

Total liabilities	89,982	92,223
Shareholders’ equity	644,053	614,473
Total liabilities and shareholders’ equity	$734,035	$706,696

Table of Contents

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Year Ended December 31 (Dollars in thousands)	2015	2014	2013
Income:			
Dividends from bank subsidiary	$36,064	$33,810	$30,429
Rental income from subsidiaries	2,342	2,314	2,165
Other	426	408	418
Investment securities and other investment gains (losses)	26	(370)	626
Total income	38,858	36,162	33,638
Expenses:			
Interest on subordinated notes	4,220	4,220	4,220
Interest on long-term debt and mandatorily redeemable securities	1,375	1,475	999
Interest on commercial paper and other short-term borrowings	30	36	23
Rent expense	1,737	1,713	1,698
Other	351	2,553	639
Total expenses	7,713	9,997	7,579
Income before income tax benefit and equity in undistributed income of subsidiaries	31,145	26,165	26,059
Income tax benefit	1,721	2,722	1,650
Income before equity in undistributed income of subsidiaries	32,866	28,887	27,709
Equity in undistributed income of subsidiaries:			
Bank subsidiaries	24,289	28,891	26,995
Non-bank subsidiaries	331	291	254
Net income	$57,486	$58,069	$54,958
Comprehensive income	$54,634	$60,895	$42,000

Table of Contents

STATEMENTS OF CASH FLOWS

Year Ended December 31 (Dollars in thousands)	2015	2014	2013
Operating activities:			
Net income	$57,486	$58,069	$54,958
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity (undistributed) distributed in excess of income of subsidiaries	(24,620)	(29,182)	(27,249)
Depreciation of premises and equipment	9	21	30
Stock-based compensation	64	35	34
Realized/unrealized investment securities and other investment (gains) losses	(26)	370	(626)
Change in trading account securities	205	(13)	(46)
Other	3,008	(1,759)	1,714
Net change in operating activities	36,126	27,541	28,815
Investing activities:			
Proceeds from sales and maturities of investment securities	1,470	—	9
Return of capital from subsidiaries	—	1,500	1
Net change in investing activities	1,470	1,500	10
Financing activities:			
Net change in commercial paper	(4,126)	(183)	7,692
Proceeds from issuance of long-term debt and mandatorily redeemable securities	1,520	1,356	1,331
Payments on long-term debt and mandatorily redeemable securities	(712)	(569)	(397)
Stock issued under stock purchase plans	149	197	168
Net proceeds from issuance of treasury stock	2,373	1,520	3,453
Acquisition of treasury stock	(9,970)	(16,342)	(2,273)
Cash dividends paid on common stock	(18,126)	(17,643)	(17,054)
Net change in financing activities	(28,892)	(31,664)	(7,080)
Net change in cash and cash equivalents	8,704	(2,623)	21,745
Cash and cash equivalents, beginning of year	51,725	54,348	32,603
Cash and cash equivalents, end of year	$60,429	$51,725	$54,348

Table of Contents

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

None

Item 9A. Controls and Procedures.

1st Source carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, at December 31, 2015, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by 1st Source in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

In addition, there were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the fourth fiscal quarter of 2015 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of 1st Source Corporation ("1st Source") is responsible for establishing and maintaining adequate internal control over financial reporting. 1st Source's internal control over financial reporting includes policies and procedures pertaining to 1st Source's ability to record, process, and report reliable information. Actions are taken to correct any deficiencies as they are identified through internal and external audits, regular examinations by bank regulatory agencies, 1st Source's formal risk management process, and other means. 1st Source's internal control system is designed to provide reasonable assurance to 1st Source's management and Board of Directors regarding the preparation and fair presentation of 1st Source's published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

1st Source's management assessed the effectiveness of internal control over financial reporting as of December 31, 2015. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework (2013 framework). Based on management's assessment, 1st Source believes that, as of December 31, 2015, 1st Source's internal control over financial reporting is effective based on those criteria.

BKD LLP, independent registered public accounting firm, has issued an attestation report on management's assessment of 1st Source's internal control over financial reporting. This report appears on page 36.

By /s/ CHRISTOPHER J. MURPHY III
Christopher J. Murphy III, Chief Executive Officer

By /s/ ANDREA G. SHORT
Andrea G. Short, Treasurer and Chief Financial Officer

South Bend, Indiana

Item 9B. Other Information.

None

Table of Contents

Part III

Item 10. Directors, Executive Officers and Corporate Governance.

The information under the caption "Proposal Number 1: Election of Directors," "Board Committees and Other Corporate Governance Matters," and "Section 16(a) Beneficial Ownership Reporting Compliance" of the 2016 Proxy Statement is incorporated herein by reference.

Item 11. Executive Compensation.

The information under the caption "Compensation Discussion & Analysis" of the 2016 Proxy Statement is incorporated herein by reference.

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

The information under the caption "Voting Securities and Principal Holders Thereof" and "Proposal Number 1: Election of Directors" of the 2016 Proxy Statement is incorporated herein by reference.

The following table shows Equity Compensation Plan Information as of December 31, 2015.

	(A) 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 [excluding securities reflected in column (A)]	
Equity compensation plans approved by shareholders				
2011 Stock Option Plan	—	$ —	2,200,000	(1)
1997 Employee Stock Purchase Plan	10,961	28.25	130,037	(1)
1982 Executive Incentive Plan	—	—	123,413	(1)(2)(3)
1982 Restricted Stock Award Plan	—	—	28,741	(1)(2)
Strategic Deployment Incentive Plan (4)	—	—	98,645	(1)(2)(3)
Total plans approved by shareholders	10,961	$ 28.25	2,580,836	
Equity compensation plans not approved by shareholders				
Director Retainer Stock Plan	—	—	76,087	(1)
Total equity compensation plans	10,961	$ 28.25	2,656,923	

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

(2) Amount is to be awarded by grants administered by the Executive Compensation and Human Resources Committee of the 1st Source Board of Directors.

(3) Amount includes market value stock only. Book value shares used for annual awards may only be sold to 1st Source.

(4) Formerly known as 1998 Performance Compensation Plan.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information under the caption "Proposal Number 1: Election of Directors", "Board Committees and Other Corporate Governance Matters, " and "Transactions with Related Persons" of the 2016 Proxy Statement is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

The information under the caption "Relationship with Independent Registered Public Accounting Firm" of the 2016 Proxy Statement is incorporated herein by reference.

Table of Contents

Part IV
Item 15. Exhibits and Financial Statement Schedules.
(a) Financial Statements and Schedules:
The following Financial Statements and Supplementary Data are filed as part of this annual report:

Financial statement schedules required by Article 9 of Regulation S-X are not required under the related instructions, or are inapplicable and, therefore, have been omitted.
(b) Exhibits (numbered in accordance with Item 601 of Regulation S-K):

3(a)	Articles of Incorporation of Registrant, amended April 30, 1996, filed as exhibit to Form 10-K, dated December 31, 1996, and incorporated herein by reference.
3(b)	By-Laws of Registrant, as amended October 22, 2015, filed herewith.
3(c)	Certificate of Designations for Series A Preferred Stock, dated January 23, 2009, filed as exhibit to Form 8-K, dated January 23, 2009, and incorporated herein by reference.
4(a)	Form of Common Stock Certificates of Registrant, filed as exhibit to Registration Statement 2-40481 and incorporated herein by reference.
4(b)	1st Source agrees to furnish to the Commission, upon request, a copy of each instrument defining the rights of holders of Senior and Subordinated debt of 1st Source.
10(a)(1)	Employment Agreement of Christopher J. Murphy III, dated January 1, 2008, filed as exhibit to Form 8-K, dated March 17, 2008, amended February 6, 2014, filed as exhibit to Form 8-K, dated March 12, 2014, and incorporated herein by reference.
10(a)(2)	Employment Agreement of Andrea G. Short dated January 1, 2013, filed as exhibit to Form 10-K, dated December 31, 2012, amended February 6, 2014, filed as exhibit to Form 8-K, dated March 12, 2014, and incorporated herein by reference.
10(a)(3)	Employment Agreement of John B. Griffith, dated January 1, 2008, filed as exhibit to Form 8-K, dated March 17, 2008, amended February 6, 2014, filed as exhibit to Form 8-K, dated March 12, 2014, and incorporated herein by reference.
10(a)(4)	Employment Agreement of Steven J. Wessell, dated June 1, 2011, filed as exhibit to Form 10-Q, dated March 31, 2012, amended February 6, 2014, filed as exhibit to Form 8-K, dated March 12, 2014, and incorporated herein by reference.
10(b)	1st Source Corporation Employee Stock Purchase Plan dated April 17, 1997, filed as exhibit to Form 10-K, dated December 31, 1997, and incorporated herein by reference.
10(c)	1st Source Corporation 1982 Executive Incentive Plan, amended February 3, 2011, filed as exhibit to Form 10-K, dated December 31, 2010, and incorporated herein by reference.

10(d)	1st Source Corporation 1982 Restricted Stock Award Plan, amended January 17, 2003, filed as exhibit to Form 10-K, dated December 31, 2003, and incorporated herein by reference.
10(e)	1st Source Corporation Strategic Deployment Incentive Plan, formerly known as the 1998 Performance Compensation Plan, amended January 20, 2011, filed as exhibit to Form 10-K, dated December 31, 2010, and incorporated herein by reference.
10(f)	Contract with Fiserv Solutions, Inc. dated November 23, 2005, filed as exhibit to Form 10-K, dated December 31, 2005, and incorporated herein by reference.
10 (g)	1st Source Corporation 2011 Stock Option Plan, dated January 20, 2011, filed as exhibit to Form 10-K, dated December 31, 2010, and incorporated herein by reference.
10 (h)	1st Source Corporation Director Retainer Stock Plan, amended July 24, 2014, filed as exhibit to Form 10-Q, dated September 30, 2014, and incorporated herein by reference.

Table of Contents

21 Subsidiaries of Registrant (unless otherwise indicated, each subsidiary does business under its own name):

Name	Jurisdiction
1st Source Bank	Indiana
SFG Aircraft, Inc. * (formerly known as SFG Equipment Leasing, Inc.)	Indiana
1st Source Insurance, Inc. *	Indiana
1st Source Specialty Finance, Inc. *	Indiana
1st Source Leasing, Inc.	Indiana
1st Source Capital Corporation *	Indiana
Trustcorp Mortgage Company (Inactive)	Indiana
1st Source Master Trust	Delaware
Michigan Transportation Finance Corporation *	Michigan
1st Source Intermediate Holding, LLC	Delaware
1st Source Funding, LLC (Inactive)	Delaware
1st Source Corporation Investment Advisors, Inc. *	Indiana
SFG Commercial Aircraft Leasing, Inc. *	Indiana
SFG Equipment Leasing Corporation I*	Indiana
Washington and Michigan Insurance, Inc.*	Arizona

*Wholly-owned subsidiaries of 1st Source Bank

23(a) Consent of BKD,LLP, Independent Registered Public Accounting Firm.

23(b) Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.

31.1 Certification of Christopher J. Murphy III, Chief Executive Officer (Rule 13a-14(a)).

31.2 Certification of Andrea G. Short, Chief Financial Officer (Rule 13a-14(a)).

32.1 Certification of Christopher J. Murphy III, Chief Executive Officer.

32.2 Certification of Andrea G. Short, Chief Financial Officer.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB XBRL Taxonomy Extension Labels Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

(c) Financial Statement Schedules — None.

Table of Contents

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.

1st SOURCE CORPORATION

By /s/ CHRISTOPHER J. MURPHY III

Christopher J. Murphy III, Chairman of the Board
and Chief Executive Officer

Date: February 19, 2016

Table of Contents

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ CHRISTOPHER J. MURPHY III Christopher J. Murphy III	Chairman of the Board and Chief Executive Officer	February 19, 2016
/s/ JAMES R. SEITZ James R. Seitz	President	February 19, 2016
/s/ ANDREA G. SHORT Andrea G. Short	Treasurer, Chief Financial Officer and Principal Accounting Officer	February 19, 2016
/s/ JOHN B. GRIFFITH John B. Griffith	Secretary and General Counsel	February 19, 2016
/s/ ALLISON N. EGIDI Allison N. Egidi	Director	February 19, 2016
/s/ DANIEL B. FITZPATRICK Daniel B. Fitzpatrick	Director	February 19, 2016
/s/ CRAIG A. KAPSON Craig A. Kapson	Director	February 19, 2016
/s/ NAJEEB A. KHAN Najeeb A. Khan	Director	February 19, 2016
/s/ VINOD M. KHILNANI Vinod M. Khilnani	Director	February 19, 2016
/s/ REX MARTIN Rex Martin	Director	February 19, 2016
/s/ CHRISTOPHER J. MURPHY IV Christopher J. Murphy IV	Director	February 19, 2016
/s/ TIMOTHY K. OZARK Timothy K. Ozark	Director	February 19, 2016
/s/ JOHN T. PHAIR John T. Phair	Director	February 19, 2016
/s/ MARK D. SCHWABERO Mark D. Schwabero	Director	February 19, 2016