1ST SOURCE CORP
Form 10-K
February 19, 2010

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

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition from____________to____________

Commission file number 0-6233

1ST SOURCE CORPORATION
(Exact name of registrant as specified in its charter)

Indiana (State or other jurisdiction of incorporation or organization)	35-1068133 (I.R.S. Employer Identification No.)
100 North Michigan Street South Bend, Indiana (Address of principal executive offices)	46601 (Zip Code)

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

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

Title of 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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the proceeding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. o

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, 2009 was $235,847,079

The number of shares outstanding of each of the registrant's classes of stock as of February 15, 2010:
Common Stock, without par value — 24,283,209 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the annual proxy statement for the 2010 annual meeting of shareholders to be held April 22, 2010, are incorporated by reference into Part III.

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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 our subsidiaries (collectively referred to as "1st Source"), a broad array of financial products and services. 1st Source Bank ("Bank"), our banking subsidiary, offers commercial and consumer banking services, trust and investment management services, and insurance to individual and business clients through most of our 76 banking center locations in 17 counties in Indiana and Michigan. 1st Source Bank's Specialty Finance Group, with 23 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, construction equipment, and environmental equipment. While concentrated in certain equipment types, we serve a diverse client base. We are not dependent upon any single industry or client. At December 31, 2009, we had consolidated total assets of $4.54 billion, loans and leases of $3.09 billion, deposits of $3.65 billion, and total shareholders' equity of $570.32 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 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 and cash management services.

Consumer Services — 1st Source Bank provides a full range of consumer banking services, including checking accounts, on-line banking including bill payment, telephone banking, savings programs, installment and real estate loans, home equity loans and lines of credit, drive-through and night deposit services, safe deposit facilities, automated teller machines, overdraft facilities, debit and credit card services, financial literacy seminars and brokerage services.

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 five areas: auto and light trucks; environmental equipment; medium and heavy duty trucks; new and used aircraft; and construction equipment.

The auto and light truck division consists of financings to automobile rental and leasing companies, light truck rental and leasing companies, and special purpose vehicles. The auto and light truck finance receivables generally range from $100,000 to $14 million with fixed or variable interest rates and terms of one to five years.

Environmental equipment financing handles trash and recycling equipment for municipalities and private businesses as well as equipment for landfills. Receivables generally range from $50,000 to $4 million with fixed or variable interest rates and terms of one to seven years.

The medium and heavy duty truck division provides 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 $9 million with fixed or variable interest rates and terms of three to seven years.

Aircraft financing consists of financings for new and used general aviation aircraft for private and corporate aircraft users, aircraft distributors and dealers, air charter operators, air cargo carriers, and other aircraft operators. We have selectively entered the business aircraft markets of Argentina, Brazil, Canada, Luxembourg, Mexico and Uruguay on a limited basis where desirable aircraft financing opportunities exist. Aircraft finance receivables generally range from $500,000 to $14 million with fixed or variable interest rates and terms of one to ten years.

Construction equipment financing includes financing of equipment (i.e., asphalt and concrete plants, bulldozers, excavators, cranes, and loaders, etc.) to the construction industry. Construction equipment finance receivables generally range from $100,000 to $14 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, various trucks, 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, 1st Source Commercial Aircraft Leasing, Inc., and SFG Equipment Leasing Corporation I.

First National Bank, Valparaiso

First National Bank, Valparaiso (First National) was a wholly owned subsidiary of 1st Source Corporation that was acquired on May 31, 2007 for $134.19 million. On June 6, 2008, First National was merged with 1st Source Bank.

Trustcorp Mortgage Company

Trustcorp Mortgage Company (Trustcorp) is a mortgage banking company and is a wholly owned subsidiary of 1st Source Corporation. During 2007, its mortgage activity was merged with 1st Source Bank and the company is now inactive.

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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 seven 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 to trust and investment clients of 1st Source Bank. Investment Advisorsis 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 Capital Trust IV and 1st Source Master Trust

Our unconsolidated subsidiaries include 1st Source Capital Trust IV and 1st Source Master Trust. These subsidiaries were created for the purposes of issuing $30.00 million and $57.00 million of trust preferred securities, respectively, 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. 1st Source Capital Trust II and 1st Source Capital Trust III were dissolved during 2008.

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 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, 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, 2009, we had approximately 1,170 employees on a full-time equivalent basis. We provide a wide range of employee benefits and consider employee relations to be good.

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 (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.

1st Source 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 1st Source 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, as amended, 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, 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.

Financial Institutions Reform, Recovery and Enforcement Act of 1989 — The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) reorganized and reformed the regulatory structure applicable to financial institutions generally.

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The Federal Deposit Insurance Corporation Improvement Act of 1991 — The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) was adopted to supervise and regulate a wide variety of banking issues. In general, FDICIA provides for the recapitalization of the Bank Insurance Fund (BIF), 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, 2009, 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 6.00%, 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.

Federal Deposit Insurance Reform Act — On February 1, 2006, Congress approved the Federal Deposit Insurance Reform Act of 2005 (FDIRA). Among other things, the FDIRA provides for the merger of the Bank Insurance Fund with the Savings Association Insurance Fund and for an immediate increase in Federal deposit insurance for certain retirement accounts up to $250,000. The statute further provides for the indexing of the maximum deposit insurance coverage for all types of deposit accounts in the future to account for inflation. The FDIRA also requires the FDIC to provide certain banks and thrifts that were in existence prior to December 31, 1996 with one-time credits against future premiums based on the amount of their payments to the Bank Insurance Fund or Savings Association Insurance Fund prior to that date.

FDIC Deposit Insurance Assessments — On October 16, 2008, in response to the problems facing the financial markets and the economy, the Federal Deposit Insurance Corporation published a restoration plan (Restoration Plan) designed to replenish the Deposit Insurance Fund (DIF) such that the reserve ratio would return to 1.15 percent within five years. On December 16, 2008, the FDIC adopted a final rule increasing risk-based assessment rates uniformly by seven basis points, on an annual basis, for the first quarter 2009.

On February 27, 2009, the FDIC concluded that the problems facing the financial services sector and the economy at large constituted extraordinary circumstances and amended the Restoration Plan and extended the time within which the reserve ratio would return to 1.15 percent from five to seven years (Amended Restoration Plan). In May 2009, Congress amended the statutory provision governing establishment and implementation of a Restoration Plan to allow the FDIC eight years to bring the reserve ratio back to 1.15 percent, absent extraordinary circumstances.

On May 22, 2009, the FDIC adopted a final rule imposing a five basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. The special assessment was collected on September 30, 2009.

In a final rule issued on September 29, 2009, the FDIC amended the Amended Restoration Plan as follows:

- The period of the Amended Restoration Plan was extended from seven to eight years.
- The FDIC announced that it will not impose any further special assessments under the final rule it adopted in May 2009.
- The FDIC announced plans to maintain assessment rates at their current levels through the end of 2010. The FDIC also immediately adopted a uniform three basis point increase in assessment rates effective January 1, 2011 to ensure that the DIF returns to 1.15 percent within the Amended Restoration Plan period of eight years.
- The FDIC announced that, at least semi-annually following the adoption of the Amended Restoration Plan, it will update its loss and income projections for the DIF. The FDIC also announced that it may, if necessary, adopt a new

rule prior to the end of the eight-year period to increase assessment rates in order to return the reserve ratio to 1.15 percent.

On November 12, 2009, the FDIC adopted a final rule to require insured institutions to prepay their quarterly risk-based deposit insurance assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012, on December 30, 2009. Our payment was $20.26 million.

Temporary Liquidity Guarantee Program — On November 21, 2008, the FDIC Board of Directors adopted a final rule implementing the Temporary Liquidity Guarantee Program (TLGP). The TLGP consists of two basic components: a guarantee of newly issued senior unsecured debt of banks, thrifts, and certain holding companies (the debt guarantee program) and full guarantee of non-interest bearing deposit transaction accounts, such as business payroll accounts, regardless of dollar amount (the transaction account guarantee program). The purpose of the guarantee of transaction accounts and the debt guarantee is to reduce funding costs and allow banks and thrifts to increase lending to consumers and businesses. All insured depository institutions were automatically enrolled in both programs unless they elected to opt out by a specified date. 1st Source did not elect to opt out and thus participates in both programs. On March 17, 2009, the FDIC extended the debt guarantee portion of the TLGP from June 30, 2009 to October 31, 2009 and imposed a surcharge on debt issued with a maturity of one year or more beginning in the second quarter to gradually phase out the program. The transaction account guarantee program is in effect until June 30, 2010.

Emergency Economic Stabilization Act of 2008 — On October 3, 2008, President George W. Bush signed the Emergency Economic Stabilization Act of 2008 (EESA). This Act temporarily raises the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor effective immediately. This temporary increase in the deposit insurance limit expires on December 31, 2013.

Under the Troubled Asset Relief Program established by EESA, the U.S. Treasury Department announced a Capital Purchase Program (CPP). CPP is 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 will purchase up to $250 billion of senior preferred shares on standardized terms as described in the program's term sheet. The program is available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities that elect submitted applications to Treasury by November 14, 2008. EESA provides for Treasury to determine an applicant’s eligibility to participate in the CPP after consulting with the appropriate federal banking agency.

1st Source submitted an application to participate in the CPP and obtained Treasury approval on December 11, 2008. On January 23, 2009, 1st Source issued preferred stock valued at $111.00 million and a warrant to acquire 837,947 shares of its common stock to Treasury pursuant to the CPP. The warrant is exercisable at any time during the ten-year period following issuance at an exercise price of $19.87.

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.

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Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 — Congress enacted the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) in September 1994. Beginning in September 1995, bank holding companies have the right to expand, by acquiring existing banks, into all states, even those which had theretofore restricted entry. The legislation also provides that, subject to future action by individual states, a holding company has the right to convert the banks which it owns in different states to branches of a single bank. The states of Indiana and Michigan have adopted the interstate branching provisions of the Interstate Act.

Economic Growth and Regulatory Paperwork Reduction Act of 1996 — The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) was signed into law on September 30, 1996. Among other things, EGRPRA streamlined the non-banking activities application process for well-capitalized and well-managed bank holding companies.

Gramm-Leach-Bliley Act of 1999 — The Gramm-Leach-Bliley Act of 1999 (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, however, 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.

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.

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 United States Treasury Department under the USA Patriot Act impose new obligations on 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. Our management believes that the risk-weighting of assets and the risk-based capital guidelines do not have a material adverse impact on our operations or on the operations of the Bank.

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 — 1st Source 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.

1st Source 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.

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Reserve Requirements — The Federal Reserve requires all depository institutions to maintain reserves against their transaction account deposits. The Bank must maintain reserves of 3.00% against net transaction accounts greater than $10.70 million and up to $44.50 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 $44.50 million.

Dividends — The ability of the Bank to pay dividends is limited by state and Federal Regulations that require 1st Source Bank to obtain the prior approval of the DFI before paying a dividend that, together with other dividends it has paid during a calendar year, would exceed the sum of its retained 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.

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 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 — On July 30, 2002, the Sarbanes-Oxley Act of 2002 (SOA) was signed into law. The SOA's stated goals include enhancing corporate responsibility, increasing penalties for accounting and auditing improprieties at publicly traded companies and protecting investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SOA generally applies to all companies that file or are required to file periodic reports with the SEC under the Securities Exchange Act of 1934 (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 registered public accounting firm, in their annual reports to stockholders.

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. On December 11, 2009, the House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 3996) that, among other things, would create a Consumer Financial Protection Agency, a new federal banking agency with the sole mission of protecting consumers when they borrow money, make deposits, or obtain other financial products and services. The bill also specifically targets systemic risk within the financial system, focusing primarily on the potential harm that regulatory gaps involving large, interconnected companies can pose to the economy. We cannot predict whether or in what form Congress may adopt final legislation incorporating the provisions of H.R. 3996, or whether it may adopt other legislation, or the extent to which our business may be affected thereby.

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.

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 affect 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.

Future expansion involves risks — In the future, we may acquire all or part of other financial institutions and we may establish de novo branch offices. There could be considerable costs involved in executing our growth strategy. For instance, new branches generally require a period of time to generate sufficient revenues to offset their costs, especially in areas in which we do not have an established presence. Accordingly, any new branch expansion could be expected to negatively impact earnings for some period of time until the branch reaches certain economies of scale. Acquisitions and mergers involve a number of risks, including the risk that:

- We may incur substantial costs identifying and evaluating potential acquisitions and merger partners, or in evaluating new markets, hiring experienced local managers, and opening new offices;
- Our estimates and judgments used to evaluate credit, operations, management, and market risks relating to target institutions may not be accurate;
- There may be substantial lag-time between completing an acquisition or opening a new office and generating sufficient assets and deposits to support costs of the expansion;
- We may not be able to finance an acquisition, or the financing we obtain may have an adverse effect on our operating results or dilution of our existing shareholders;
- The attention of our management in negotiating a transaction and integrating the operations and personnel of the combining businesses may be diverted from our existing business;
- Acquisitions typically involve the payment of a premium over book and market values and; therefore, some dilution of our tangible book value and net income per common share may occur in connection with any future transaction;
- We may enter new markets where we lack local experience;
- We may incur goodwill in connection with an acquisition, or the goodwill we incur may become impaired, which results in adverse short-term effects on our operating results; or
- We may lose key employees and clients.

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.

We are dependent upon the services of our management team — Our future success and profitability is substantially dependent upon our management and the banking abilities 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 and constant technological change — Any compromise of our security also could deter our clients from using our internet banking services that involve the transmission of confidential information. We rely on standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. 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.

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 competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our 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.

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.

In the financial services industry, there is always a risk that certain borrowers may not repay borrowings. 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 economic conditions could also adversely affect the quality of our loan and lease portfolio and negate, to some extent, the benefits of national diversification through our Specialty Finance Group’s portfolio.

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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, and net worth; asset ownership; bank and trade credit reference; credit bureau report; 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, most residential mortgages are sold into the secondary market and serviced by our principal banking subsidiary, 1st Source Bank.

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 slow downs 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 of fuel costs. Since some of the relationships in these industries are large (up to $25 million), a slow down 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 sensitive businesses for which our specialty finance businesses provide financing.

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.

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 affect on our financial condition and results of operations.

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.

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.

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 affect on our business, financial condition and results of operations.

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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 reported financial condition and results of operations.

New economic stabilization legislation and our participation in the programs could affect us adversely— The Emergency Economic Stabilization Act of 2008 (the "EESA") is intended to stabilize and provide liquidity to the U.S. financial markets. There can be no assurance, however, as to the long term impact that the EESA and its regulations and other governmental programs will have on the financial markets. The failure of the financial markets to stabilize and a worsening of current financial market conditions could adversely affect our business, financial condition and results of operations. The programs established or to be established under the EESA and Troubled Asset Relief Program may have adverse effects on us. We may face increased regulation of our industry. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.

Our participation in the Treasury's Capital Purchase Program may adversely affect the value of our common stock and the rights of our common shareholders — The terms of the preferred stock we issued under the Treasury's Capital Purchase Program could reduce investment returns to our common shareholders by restricting dividends, diluting existing shareholders' ownership interests, and restricting capital management practices. Without the prior consent of the Treasury, we will be prohibited from increasing our common stock dividends for the first three years while the Treasury holds the preferred stock.

Also, the preferred stock requires quarterly dividends to be paid at the rate of 5% per annum for the first five years and 9% per annum thereafter until the stock is redeemed by us. The payments of these dividends will decrease the excess cash we otherwise have available to pay dividends on our common stock and to use for general corporate purposes, including working capital.

Finally, we will be prohibited from continuing to pay dividends on our common stock unless we have fully paid all required dividends on the preferred stock issued to the Treasury. Although we fully expect to be able to pay all required dividends on the preferred stock (and to continue to pay dividends on its common stock at current levels), there is no guarantee that we will be able to do so in the future.

Our deposit insurance premiums could be substantially higher in the future which will have an adverse effect on our future earnings —Under the Federal Deposit Insurance Act, the FDIC, absent extraordinary circumstances, must establish and implement a plan to restore the deposit insurance reserve ratio to 1.15% of insured deposits, over an eight-year period, at any time that the reserve ratio falls below 1.15%. The FDIC expects a higher rate of insured institution failures in the next few years, which may result in a continued decline in the reserve ratio.

As a member institution of the FDIC, we are required to pay semi-annual deposit insurance premium assessments to the FDIC. Due to the continued failures of FDIC insured depository institutions, FDIC insurance premiums have increased. We anticipate that our FDIC deposit insurance premiums may increase in the future, perhaps significantly, which will adversely impact our future earnings.

Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

Our headquarters building is located in downtown South Bend. In 1982, the land was leased from the City of South Bend on a 49-year lease, with a 50-year renewal option. The building is part of a larger complex, including a 300-room hotel and a 500-car parking garage. Also, in 1982, we sold the building and entered into a leaseback agreement with the purchaser for a term of 30 years. The building is a structure of approximately 160,000 square feet, with 1st Source and our subsidiaries occupying approximately 65% of the available office space and approximately 35% subleased to unrelated tenants.

At December 31, 2009, we also owned property and/or buildings on which 55 of the 1st Source Bank's 76 banking centers were located, including the facilities in Allen, Elkhart, Fulton, Huntington, Kosciusko, LaPorte, Marshall, Porter, St. Joseph, Starke, and Wells Counties in the State of Indiana and Berrien and Cass Counties in the State of Michigan, as well as an operations center, warehouse, 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.

Item 3. Legal Proceedings.

1st Source and our subsidiaries are involved in various 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. Submission of Matters to a Vote of Security Holders.

None

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Part II

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.

	2009 Sales Price		Cash Dividends	2008 Sales Price		Cash Dividends
Common Stock Prices (quarter ended)	High	Low	Paid	High	Low	Paid
March 31	$ 23.92	$ 14.16	$ .14	$ 21.81	$ 15.13	$ .14
June 30	21.98	15.36	.14	22.62	16.10	.14
September 30	17.94	14.52	.15	30.00	14.54	.14
December 31	16.60	13.84	.16	25.56	12.61	.16

As of December 31, 2009, there were 967 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, 2004, 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 124 banking companies in Illinois, Indiana, Michigan, Ohio, and Wisconsin.

NOTE: Total return assumes reinvestment of dividends.

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The following table summarizes our share repurchase activity during the three months ended December 31, 2009.

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, 2009	4,000	$14.79	4,000	1,390,572
November 01 - 30, 2009	21,533	14.29	21,533	1,369,039
December 01 - 31, 2009	4,900	14.39	4,900	1,364,139

*1st Source maintains a stock repurchase plan that was authorized by the Board of Directors on April 26, 2007. Under the terms of the plan, 1st Source may repurchase up to
2,000,000 shares of its common stock when favorable conditions exist on the open market or through private transactions at various prices from time to time. Since the inception
of the plan, 1st Source has repurchased a total of 635,861 shares.

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. In addition, as a result of our participation in the TARP Capital Purchase Program, we may not increase the quarterly dividends we pay on our common stock above $0.16 per share during the three-year period ending January 23, 2012, without the consent of the U.S. Treasury Department, unless the Treasury Department no longer holds shares of the Series A Preferred Stock we issued in the TARP Capital Purchase Program.

Item 6. Selected Financial Data.

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

(Dollars in thousands, except per share amounts)	2009	2008	2007 (2)	2006	2005
Interest income	$ 200,412	$ 235,308	$ 253,587	$ 208,994	$ 168,532
Interest expense	72,200	103,148	134,677	102,561	70,104
Net interest income	128,212	132,160	118,910	106,433	98,428
Provision for (recovery of) loan and lease losses	31,101	16,648	7,534	(2,736)	(5,855)
Net interest income after provision for (recovery of) loan and lease losses	97,111	115,512	111,376	109,169	104,283
Noninterest income	85,530	84,003	70,619	76,585	68,533
Noninterest expense	151,123	153,114	140,312	126,211	123,439
	31,518	46,401	41,683	59,543	49,377

Income before income taxes														
Income taxes		6,028			13,015			11,144			20,246			15,626	
Net income		25,490			33,386			30,539			39,297			33,751	
Net income available to common shareholders	$	19,074		$	33,386		$	30,539		$	39,297		$	33,751	
Assets at year-end	$	4,542,100		$	4,464,174		$	4,447,104		$	3,807,315		$	3,511,277	
Long-term debt and mandatorily redeemable securities at year-end		19,761			29,832			34,702			43,761			23,237	
Shareholders' equity at year-end (3)		570,320			453,664			430,504			368,904			345,576	
Basic net income per common share (1)		0.79			1.38			1.30			1.74			1.48	
Diluted net income per common share (1)		0.79			1.37			1.28			1.72			1.46	
Cash dividends per common share (1)		.590			.580			.560			.534			.445	
Dividend payout ratio		74.68	%		42.34	%		43.75	%		31.05	%		30.48	%
Return on average assets		0.57	%		0.76	%		0.74	%		1.11	%		1.00	%
Return on average common equity		4.07	%		7.52	%		7.47	%		10.98	%		10.12	%
Average common equity to average assets		10.40	%		10.09	%		9.85	%		10.07	%		9.89	%

(1) The computation of per common share data gives retroactive recognition to a 10% stock dividend declared July 27, 2006.
(2) Results for 2007 and later include the acquisition of FINA Bancorp, Inc.
(3) Results for 2009 include the issuance of Preferred Stock under TARP. Refer to Note 13 of the Notes to Consolidated Financial Statements for further details.

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.

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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. These 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 increases 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.
- 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.

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 our management to make estimates or judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates or judgments reflect our 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 three policies as being critical because they require our 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, the valuation of mortgage servicing rights, and fair value measurements. Our management 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. Our 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.

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Reserve for Loan and Lease Losses — The reserve for loan and lease losses represents our 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 adequate reserve, our 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, our management benefits from a lengthy organizational history and experience with credit decisions and related outcomes. Nonetheless, if our 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, 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 Values of Financial Instruments."

Mortgage Servicing Rights Valuation — We recognize as assets the rights to service mortgage loans for others, known as mortgage servicing rights, whether the servicing rights are acquired through purchases or through originated loans. Mortgage servicing rights do not trade in an active open market with readily observable market prices. Although sales of mortgage servicing rights do occur, the precise terms and conditions may not be readily available. As such, the value of mortgage servicing assets are established and valued using discounted cash flow modeling techniques which require management to make estimates regarding estimated future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors. The expected rates of mortgage loan prepayments are the most significant factors driving the value of mortgage servicing assets. 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 mortgage servicing assets, mortgage interest rates (which are used to determine prepayment rates), and discount rates are held constant over the estimated life of the portfolio. Expected mortgage loan prepayment rates are derived from a third-party model and adjusted to reflect our actual prepayment experience. Mortgage servicing assets 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 mortgage servicing assets is discussed further in Note 21, "Fair Values of Financial Instruments."

Earnings Summary

Net income in 2009 was $25.49 million, down from $33.39 million in 2008 and down from $30.54 million in 2007. Diluted net income per common share was $0.79 in 2009, $1.37 in 2008, and $1.28 in 2007. Return on average total assets was 0.57% in 2009 compared to 0.76% in 2008, and 0.74% in 2007. Return on average common shareholders' equity was 4.07% in 2009 versus 7.52% in 2008, and 7.47% in 2007.

Net income in 2009 was negatively impacted by a $14.45 million or 86.82% increase in provision for loan and lease losses over 2008 and a reduction of $11.49 million gain due to sale of certain assets of Investment Advisors in 2008, which was offset by an improvement of $11.68 million or 116.88% in investment securities due to impairment recorded in 2008 that was not present in 2009. Net income in 2008, as compared to 2007, was favorably affected by a $13.25 million or 11.14% increase in net interest income, the $11.49 million gain on the sale of certain assets of Investment Advisors and increased noninterest income. However, these increases were offset by increased provision for loan and lease losses, investment securities impairment and increased noninterest expenses.

Dividends paid on common stock in 2009 amounted to $0.59 per share, compared to $0.58 per share in 2008, and $0.56 per share in 2007. The level of earnings reinvested and dividend payouts are based on management’s assessment of future growth opportunities and the level of capital necessary to support them.

Acquisition of First National Bank, Valparaiso — On May 31, 2007, we acquired FINA Bancorp (FINA), the parent company of First National Bank, Valparaiso for $134.19 million. First National was a full service bank with 16 banking facilities, as of December 31, 2007, located in Porter and LaPorte Counties of Indiana. Pursuant to the definitive agreement, FINA shareholders were able to choose whether to receive 1st Source common stock and/or cash pursuant to the election procedures described in the definitive agreement. Under the terms of the transaction, FINA was acquired in exchange for 2,124,974 shares of 1st Source common stock valued at $53.68 million and $80.51 million in cash. The value of the common stock was $25.26 per share. We believe that the purchase of FINA is a natural extension of our service area and is consistent with our growth and market expansion initiatives. On June 6, 2008, First National was merged with 1st Source Bank.

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 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 3.14% in 2009 compared to 3.34% in 2008, and 3.18% in 2007. The lower margin in 2009 reflects the decline in yields on earning assets which was partially offset by lower funding costs. Net interest income was $128.21 million for 2009, compared to $132.16 million for 2008. Tax-equivalent net interest income totaled $132.00 million for 2009, a decrease of $3.75 million from the $135.75 million reported for 2008. The $3.75 million decrease is mainly due to changes in rates.

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During 2009, average earning assets increased $130.90 million while average interest-bearing liabilities decreased $67.19 million over the comparable period in 2008. The yield on average earning assets decreased 101 basis points to 4.86% for 2009 from 5.87% for 2008. The rate earned on assets was negatively impacted by decreases in market rates. Total cost of average interest-bearing liabilities decreased 84 basis points during 2009 as liabilities were also impacted by decreases in market rates. The result was a decrease of 20 basis points 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 2009 was the 77 basis point decrease in the loan and lease portfolio yield. The decrease in the loan and lease portfolio yield was further impacted by a decrease in net loan and lease outstandings. Average net loans and leases decreased $108.46 million or 3.32% in 2009 from 2008.

During 2009, the tax-equivalent yield on securities available for sale decreased 132 basis points to 3.28% while the average balance increased $121.21 million.

Average mortgages held for sale increased $40.25 million during 2009; however the yield decreased 83 basis points.

Average interest-bearing deposits increased $149.31 million during 2009 while the effective rate paid on those deposits decreased 88 basis points. Average non interest-bearing demand deposits increased $50.07 million during 2009.

Average short-term borrowings decreased $201.20 million during 2009 while the effective rate paid decreased 137 basis points. Average subordinated notes which represent our trust preferred borrowings decreased $1.27 million during 2009, while the effective rate decreased three basis points. Average long-term debt decreased $14.02 million during 2009 as the effective rate decreased 76 basis points.

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.

		2009			2008			200
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Inter Incor Expe
ASSETS								
Investment securities:								
Taxable	$ 629,229	$ 17,594	2.80%	$ 491,061	$ 22,170	4.51%	$ 510,949	$ 25
Tax-exempt	205,796	9,801	4.76	222,751	10,692	4.80	225,849	10
Mortgages held for sale	74,173	3,907	5.27	33,925	2,069	6.10	28,913	1
Net loans and leases	3,154,820	171,669	5.44	3,263,276	202,539	6.21	2,992,540	214
Other investments	135,494	1,228	0.91	57,601	1,425	2.47	94,478	4
Total earning assets	4,199,512	204,199	4.86	4,068,614	238,895	5.87	3,852,729	257

Cash and due from banks	59,626			83,270			81,714	
Reserve for loan and lease losses	(85,095)			(71,358)			(61,555)	
Other assets	331,809			319,997			278,421	
Total assets	$ 4,505,852			$ 4,400,523			$ 4,151,309	
LIABILITIES AND SHAREHOLDERS' EQUITY								
Interest bearing deposits	$ 3,146,135	$ 63,521	2.02%	$ 2,996,830	$ 86,903	2.90%	$ 2,918,756	$ 115
Short-term borrowings	185,647	1,115	0.60	386,850	7,626	1.97	271,377	10
Subordinated notes	89,692	6,589	7.35	90,960	6,714	7.38	82,414	6
Long-term debt and mandatorily redeemable securities	20,448	975	4.77	34,472	1,905	5.53	42,265	2
Total interest bearing liabilities	3,441,922	72,200	2.10	3,509,112	103,148	2.94	3,314,812	134
Noninterest bearing deposits	427,513			377,440			351,050	
Other liabilities	69,953			69,823			76,472	
Shareholders' equity	566,464			444,148			408,975	
Total liabilities and shareholders' equity	$ 4,505,852			$ 4,400,523			$ 4,151,309	
Net interest income		$ 131,999			$ 135,747			$ 122
Net interest margin on a tax equivalent basis			3.14%			3.34%		

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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
2009 compared to 2008			
Interest earned on:			
Investment securities:			
Taxable	$ 12,787	$ (17,363)	$ (4,576)
Tax-exempt	(803)	(88)	(891)
Mortgages held for sale	2,077	(239)	1,838
Net loans and leases	(6,405)	(24,465)	(30,870)
Other investments	(371)	174	(197)
Total earning assets	$ 7,285	$ (41,981)	$ (34,696)
Interest paid on:			
Interest bearing deposits	$ 4,560	$ (27,942)	$ (23,382)
Short-term borrowings	(2,787)	(3,724)	(6,511)
Subordinated notes	(98)	(27)	(125)
Long-term debt and mandatorily redeemable securities	(695)	(235)	(930)
Total interest bearing liabilities	$ 980	$ (31,928)	$ (30,948)
Net interest income	$ 6,305	$ (10,053)	$ (3,748)
2008 compared to 2007			
Interest earned on:			
Investment securities:			
Taxable	$ (927)	$ (2,039)	$ (2,966)
Tax-exempt	(153)	45	(108)
Mortgages held for sale	290	(113)	177
Net loans and leases	24,816	(37,002)	(12,186)
Other investments	(1,417)	(1,815)	(3,232)
Total earning assets	$ 22,609	$ (40,924)	$ (18,315)
Interest paid on:			
Interest bearing deposits	$ 3,045	$ (31,255)	$ (28,210)
Short-term borrowings	16,581	(19,890)	(3,309)
Subordinated notes	630	33	663
Long-term debt and mandatorily redeemable securities	(447)	(226)	(673)
Total interest bearing liabilities	$ 19,809	$ (51,338)	$ (31,529)
Net interest income	$ 2,800	$ 10,414	$ 13,214

Noninterest Income — Noninterest income increased $1.53 million or 1.82% in 2009 from 2008 following a $13.38 million or 18.95% increase in 2008 over 2007. Noninterest income for the most recent three years ended December 31 was as follows:

(Dollars in thousands)	2009	2008	2007
Noninterest income:			
Trust fees	$ 15,036	$ 18,599	$ 15,567
Service charges on deposit accounts	20,645	22,035	20,470
Mortgage banking income	8,251	2,994	2,868
Insurance commissions	4,930	5,363	4,666

Equipment rental income		25,757		24,224		21,312
Other income		9,224		9,293		8,864
Gain on sale of certain Investment Advisor assets		-		11,492		-
Investment securities and other investment gains (losses)		1,687		(9,997)		(3,128)
Total noninterest income	$	85,530	$	84,003	$	70,619

Trust fees (which include investment management fees, estate administration fees, mutual fund fees, annuity fees, and fiduciary fees) decreased by $3.56 million or 19.16% in 2009 from 2008 compared to an increase of $3.03 million or 19.48% in 2008 over 2007. 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, 2009 and 2008 was $2.80 billion and $2.65 billion, respectively. At December 31, 2009, these trust assets were comprised of $1.65 billion of personal and agency trusts, $0.77 billion of employee benefit plan assets, $294.90 million of estate administration assets and individual retirement accounts, and $81.82 million of custody assets. The decline in trust fees in 2009 was primarily due to a reduction in our investment advisory management fees received from the 1st Source Monogram Funds due to the sale of assets related to the management of such funds in December 2008. The reduction in investment advisory management fees is partially offset by earnout fees on the sale of $2.10 million which are reflected in other income.

Service charges on deposit accounts decreased $1.39 million or 6.31% in 2009 from 2008 compared to an increase of $1.57 million or 7.65% in 2008 from 2007. The decline in service charges on deposit accounts in 2009 reflects a lower volume of overdraft and nonsufficient fund transactions. The growth in service charges on deposit accounts in 2008 from 2007 reflects growth in the number of deposit accounts due to the May 2007 acquisition of First National and a higher volume of fee generating transactions, primarily overdrafts, debit card and nonsufficient funds transactions.

Mortgage banking income increased $5.26 million or 175.58% in 2009 over 2008, compared to an increase of $0.13 million or 4.39% in 2008 over 2007. In 2009, we had $2.07 million in recoveries of mortgage servicing rights impairment and increased gain on sale of loans. The increase in 2008 was primarily due to gains on mortgage loan sales which were offset by $1.91 million in mortgage servicing rights impairment. During 2009, 2008 and 2007, we determined that no permanent write-down was necessary for previously recorded impairment on mortgage servicing assets.

Insurance commissions were down $0.43 million or 8.07% in 2009 from 2008 compared to an increase of $0.70 million or 14.94% in 2008 from 2007. The lower commission income in 2009 was mainly due to lower premiums as a result of market conditions and a reduction in customer accounts. The increase for 2008 was mainly attributed to an acquisition of an insurance agency in the Fort Wayne area.

Equipment rental income generated from operating leases grew by $1.53 million or 6.33% during 2009 from 2008 compared to an increase of $2.91 million or 13.66% during 2008 from 2007. Revenues from operating leases for transportation equipment, aircraft and special purpose vehicles increased as clients responded positively to our strong marketing efforts and entered into new lease agreements.

On August 25, 2008, Investment Advisors entered into a Purchase and Sale Agreement with WA Holdings, Inc. ("Buyer") whereby Investment Advisors agreed to sell certain assets to Buyer and to enter into a long-term strategic partnership with Buyer. Pursuant to the Purchase and Sale Agreement, in December 2008, Buyer and its wholly-owned subsidiary, Wasatch Advisors, Inc., investment advisor of the Wasatch Funds, Inc., acquired assets of Investment Advisors related to the management of the 1st Source Monogram Mutual Funds - the Income Equity Fund, the Long/Short Fund and the Income Fund. The 1st Source Monogram Mutual Funds were reorganized into the Wasatch - 1st Source Income Equity Fund, the Wasatch - 1st Source Long/Short Fund, and the Wasatch - 1st Source Income Fund. Investment Advisors recorded a net gain of $11.49 million at closing, which was net of $1.51 million of legal and compensation expense.

Investment securities and other investment gains totaled $1.69 million for the year ended 2009 compared to losses of $10.00 million for the year ended 2008 and losses of $3.13 million for the year ended 2007. In 2008 and 2007, we took $10.82 million and $4.11 million, respectively, in impairment charges on investments in the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) preferred stock and

other preferred equities as a result of the deterioration in the residential mortgage business and government intervention at the FNMA and the FHLMC. Due to the uncertainty of future market conditions and how they might impact the financial performance of the FNMA and the FHLMC, we sold our remaining shares of the FHLMC and FNMA preferred stock in 2009 realizing gains of $390 thousand. Also due to market uncertainty, we sold our remaining shares of corporate preferred stocks, realizing losses of $688 thousand.

Other income remained relatively stable in 2009 from 2008 and in 2008 from 2007.

Noninterest Expense — Noninterest expense decreased $1.99 million or 1.30% in 2009 over 2008 following a $12.80 million or 9.12% increase in 2008 from 2007. Noninterest expense for the recent three years ended December 31 was as follows:

(Dollars in thousands)	2009	2008	2007
Noninterest expense:			
Salaries and employee benefits	$ 72,483	$ 76,965	$ 73,944
Net occupancy expense	9,185	9,698	9,030
Furniture and equipment expense	13,980	15,095	15,145
Depreciation — leased equipment	20,515	19,450	17,085
Professional fees	4,399	8,446	4,575
Supplies and communications	5,916	6,782	5,987
Business development and marketing expense	3,488	3,749	4,788
Loan and lease collection and repossession expense	4,283	1,162	1,123
FDIC and other insurance	8,362	2,601	1,190
Intangible asset amortization	1,352	1,393	874
Other expense	7,160	7,773	6,571
Total noninterest expense	$ 151,123	$ 153,114	$ 140,312

Total salaries and employee benefits decreased $4.48 million or 5.82% in 2009 from 2008, following a $3.02 million or 4.09% increase in 2008 from 2007.

Employee salaries decreased $0.63 million or 1.02% in 2009 from 2008 compared to an increase of $2.20 million or 3.69% in 2008 from 2007. The decline in 2009 was the result of a lower work force offset by a decline in salaries deferred relating to the origination of loans. The increase in 2008 was due to a full year of First National staff and a decline in salaries deferred relating to the origination of loans.

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Employee benefits decreased $3.85 million or 25.56% in 2009 from 2008, compared to an increase of $0.82 million or 5.74% in 2008 from 2007. The decrease in 2009 was primarily due to lower group insurance costs and a reversal of post retirement benefit obligations due to the termination of the post retirement benefit plan for new retirees. The increase in 2008 was primarily due to increased group insurance costs.

Occupancy expense decreased $0.51 million or 5.29% in 2009 from 2008, compared to an increase of $0.67 million or 7.40% in 2008 from 2007. The decrease in 2009 was mainly a result of lower repair costs on our premises. The increase in 2008 was primarily due to the increase in number of locations following the acquisition of First National.

Furniture and equipment expense, including depreciation, declined $1.12 million or 7.39% in 2009 from 2008 compared to a slight decline in 2008 from 2007. The decrease in 2009 was caused by lower depreciation expense and lower computer processing charges. During 2008 increased computer processing charges offset declines in repairs and depreciation.

Depreciation on equipment owned under operating leases increased $1.07 million or 5.48% in 2009 from 2008, following a $2.37 million or 13.84% increase in 2008 from 2007. In 2009 and 2008, depreciation on equipment owned under operating leases increased in conjunction with the increase in equipment rental income as some of our clients opted to enter into new lease arrangements rather than purchase equipment.

Professional fees decreased $4.05 million or 47.92% in 2009 from 2008, compared to a $3.87 million or 84.61% increase in 2008 from 2007. In 2008, professional fees were higher due to expenses recorded for a systems security breach that occurred in May 2008 and other consulting expenses. In 2009, professional fees returned to the 2007 level.

Supplies and communications expense decreased $0.87 million or 12.77% in 2009 from 2008 after a $0.80 million or 13.28% increase in 2008 as compared to 2007. The decrease in 2009 was primarily a result of lower postage expense and printing and supplies expense. The increase in 2008 was due to increased printing cost, freight expense and data line expense.

Business development and marketing expense decreased $0.26 million or 6.96% in 2009 from 2008 compared to a $1.04 million or 21.70% decrease in 2008 from 2007. The decrease in 2009 and 2008 was related to lower retail marketing and institutional marketing expenses.

Loan and lease collection and repossession expenses increased $3.12 million or 268.59% in 2009 from 2008 compared to remaining stable in 2008 from 2007. The increase in 2009 was due to increased collection and repossession activity as our nonperforming assets increased.

FDIC and other insurance expense increased $5.76 million or 221.49% in 2009 over 2008 versus a $1.41 million or 118.57% increase in 2008 over 2007. The increase in 2009 was due to higher Federal Deposit Insurance Corporation (FDIC) insurance premiums as insurance rates increased and a $1.98 million special FDIC insurance assessment which was calculated at 5 basis points of assets minus tier 1 capital as of June 30, 2009. The increase in 2008 was due to higher FDIC insurance premiums.

Intangible asset amortization decreased $0.04 million or 2.94% in 2009 from 2008 compared to a $0.52 million or 59.38% increase in 2008 from 2007. The decrease in 2009 was due to carrying value adjustments relating to a prior acquisition. The increase in intangible asset amortization for 2008 was due to the amortization of intangibles related to the First National acquisition.

Other expenses decreased $0.61 million or 7.89% in 2009 as compared to 2008 following an increase of $1.20 million or 18.29% in 2008 from 2007. The decrease in 2009 was due to higher deferred costs on originated loans, lower

convention costs, lower trust preferred amortization expense and lower filing expenses offset by higher mortgage loan payoff expense and lower gain on sale of operating equipment. Increased correspondent bank fees and write-downs of former bank premises held for sale contributed to the 2008 increase.

Income Taxes — 1st Source recognized income tax expense in 2009 of $6.03 million, compared to $13.02 million in 2008, and $11.14 million in 2007. The effective tax rate in 2009 was 19.13% compared to 28.05% in 2008, and 26.74% in 2007. The effective tax rate decreased in 2009 compared to 2008 due to a one time benefit of $2.60 million and an increase in tax-exempt interest in relation to income before taxes. The 2009 benefit was the result of a reduction in our tax contingency reserve due to the resolution of tax audits. The effective tax rate increased in 2008 compared to 2007 due to a decrease in tax-exempt interest in relation to income before taxes as well as an increase in state tax expense. For 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)	2009	2008	2007	2006	2005
Commercial and agricultural loans	$ 546,222	$ 643,440	$ 593,806	$ 478,310	$ 453,197
Auto, light truck and environmental equipment	349,741	353,838	305,238	317,604	310,786
Medium and heavy duty truck	204,545	243,375	300,469	341,744	302,137
Aircraft financing	617,384	632,121	587,022	498,914	459,645
Construction equipment financing	313,300	375,983	377,785	305,976	224,230
Loans secured by real estate	952,223	918,749	881,646	632,283	601,077
Consumer loans	109,735	130,706	145,475	127,706	112,359
Total loans and leases	$ 3,093,150	$ 3,298,212	$ 3,191,441	$ 2,702,537	$ 2,463,431

At December 31, 2009, 11.6% of total loans and leases were concentrated with construction end users.

Average loans and leases, net of unearned discount, decreased $108.46 million or 3.32% and increased $270.74 million or 9.05% in 2009 and 2008, respectively. Loans and leases, net of unearned discount, at December 31, 2009, were $3.09 billion and were 68.10% of total assets, compared to $3.30 billion and 73.88% of total assets at December 31, 2008.

Commercial and agricultural lending, excluding those loans secured by real estate, decreased $97.22 million or 15.11% in 2009 over 2008. Commercial and agricultural lending outstandings were $546.22 million and $643.44 million at December 31, 2009 and December 31, 2008, respectively. This decrease was

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mainly due to the weak economy in our geographic markets. Businesses reduced their working capital line of credit borrowings given lower accounts receivable and inventory levels caused by a decline in their sales. The weak economy also accounted for a reduction in term loan financing attributed to less equipment purchases by companies in our market.

Loans secured by real estate increased $33.47 million or 3.64% during 2009 over 2008. Loans secured by real estate outstanding at December 31, 2009 were $952.22 million and $918.75 million at December 31, 2008. Loans on commercial real estate, the majority of which is owner occupied, were $580.71 million at December 31, 2009 and $574.39 million at December 31, 2008. Residential mortgage lending was $371.51 million at December 31, 2009 and $344.36 million at December 31, 2008. The increase in residential mortgage lending was primarily due to a higher volume of refinance activity as a result of lower market interest rates and our decision to retain more loans in our portfolio.

Auto, light truck, and environmental equipment financing decreased $4.10 million or 1.16% in 2009 over 2008. At December 31, 2009, auto, light truck, and environmental equipment financing had outstandings of $349.74 million and $353.84 million at December 31, 2008.

Medium and heavy duty truck loans and leases decreased $38.83 million or 15.95%, in 2009. Medium and heavy duty truck financing at December 31, 2009 and 2008 had outstandings of $204.55 million and $243.38 million, respectively. Most of the decrease at December 31, 2009 from December 31, 2008 can be attributed to a reduced need for funding as over-capacity issues caused our customer base to downsize their fleets.

Aircraft financing at year-end 2009 decreased $14.74 million or 2.33% from year-end 2008. Aircraft financing at December 31, 2009 and 2008 had outstandings of $617.38 million and $632.12 million, respectively. The demand for aircraft financing in the United States declined while international demand increased.

Construction equipment financing decreased $62.68 million or 16.67% in 2009 compared to 2008. Construction equipment financing at December 31, 2009 had outstandings of $313.30 million, compared to outstandings of $375.98 million at December 31, 2008. The decrease in this category was primarily due to a national decrease in construction related activity and a substantial decrease in sales of both new and used construction equipment.

Consumer loans decreased $20.97 million or 16.04% in 2009 over 2008. Consumer loans outstanding at December 31, 2009, were $109.74 million and $130.71 million at December 31, 2008. The decrease during 2009 was due to the economic slow down which caused an increase in the unemployment rates in our primary markets, thereby decreasing the demand for consumer loans.

The following table shows the maturities of loans and leases in the categories of commercial and agriculture, auto, light truck and environmental equipment, medium and heavy duty truck, aircraft and construction equipment outstanding as of December 31, 2009. The amounts due after one year are also classified according to the sensitivity to changes in interest rates.

(Dollars in thousands)	0-1 Year	1-5 Years	Over 5 Years	Total
Commercial and agricultural loans	$ 320,731	$ 203,362	$ 22,129	$ 546,222
Auto, light truck and environmental equipment	182,983	163,220	3,538	349,741
Medium and heavy duty truck	88,320	114,946	1,279	204,545
Aircraft financing	205,095	353,945	58,344	617,384
Construction equipment financing	129,965	182,006	1,329	313,300
Total	$ 927,094	$ 1,017,479	$ 86,619	$ 2,031,192

Rate Sensitivity (Dollars in thousands)	Fixed Rate	Variable Rate	Total
1 – 5 Years	$ 613,928	$ 403,551	$ 1,017,479
Over 5 Years	7,031	79,588	86,619
Total	$ 620,959	$ 483,139	$ 1,104,098

Most of the Bank's residential mortgages are sold into the secondary market. Mortgage loans held for sale were $26.65 million at December 31, 2009 and were $46.69 million at December 31, 2008. 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.

A loan is considered a restructured loan in cases where a borrower experiences financial difficulties and we make certain concessionary modifications to contractual terms. Loans restructured at a rate equal to or greater than that of a new loan with comparable risk at the time the contract is modified may be excluded from restructured loan disclosures after a period of six months if they are in compliance with the modified terms. Restructured loans that are accruing interest total $18.31 million at December 31, 2009 and $6.74 million at December 31, 2008.

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 adequacy of the reserve quarterly, reviewing all loans and leases over a fixed-dollar amount ($100,000) where the internal credit rating 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 economic trends, 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 adequacy of the reserve for loan and lease losses.

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The reserve for loan and lease losses at December 31, 2009, totaled $88.24 million and was 2.85% of loans and leases, compared to $79.78 million or 2.42% of loans and leases at December 31, 2008 and $66.60 million or 2.09% of loans and leases at December 31, 2007. It is our opinion that the reserve for loan and lease losses was adequate to absorb losses inherent in the loan and lease portfolio as of December 31, 2009.

Charge-offs for loan and lease losses were $28.22 million for 2009, compared to $8.39 million for 2008 and $7.37 million for 2007. Charge-offs increased in 2009 and 2008 as a result of an increase in nonperforming loans and leases related to weaker economic conditions.

The provision for loan and lease losses was $31.10 million for 2009, compared to the provision for loan and lease losses of $16.65 million for 2008 and the provision for loan and lease losses of $7.53 million for 2007. The increased provision for loan and lease losses in 2009 and 2008 was due to the deterioration in the loan portfolio mainly due to the deterioration in the economy.

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

(Dollars in thousands)	2009	2008	2007	2006	2005
Amounts of loans and leases outstanding at end of period	$ 3,093,150	$ 3,298,212	$ 3,191,441	$ 2,702,537	$ 2,463,431
Average amount of net loans and leases outstanding during period	$ 3,154,820	$ 3,263,276	$ 2,992,540	$ 2,566,217	$ 2,348,690
Balance of reserve for loan and lease losses at beginning of period	$ 79,776	$ 66,602	$ 58,802	$ 58,697	$ 63,672
Charge-offs:					
Commercial and agricultural loans	8,809	1,580	1,841	1,038	1,478
Auto, light truck and environmental equipment	2,750	234	1,770	340	630
Medium and heavy duty truck	2,071	924	569	-	15
Aircraft financing	7,812	462	378	1,126	2,424
Construction equipment financing	1,476	1,695	799	118	-
Loans secured by real estate	2,753	879	356	129	167
Consumer loans	2,544	2,619	1,654	1,203	858
Total charge-offs	28,215	8,393	7,367	3,954	5,572
Recoveries:					
Commercial and agricultural loans	3,193	1,177	2,356	1,594	1,308
Auto, light truck and environmental equipment	310	330	446	430	1,140
Medium and heavy duty truck	5	248	64	59	174
Aircraft financing	983	2,230	1,779	3,612	2,255
Construction equipment financing	444	139	19	753	1,065
Loans secured by real estate	36	171	169	31	89
Consumer loans	603	624	421	316	421

Total recoveries		5,574			4,919			5,254			6,795			6,452	
Net charge-offs (recoveries)		22,641			3,474			2,113			(2,841	)		(880	)
Provision for (recovery of provision for) loan and lease losses		31,101			16,648			7,534			(2,736	)		(5,855	)
Reserves acquired in acquisitions		-			-			2,379			-			-	
Balance at end of period	$	88,236		$	79,776		$	66,602		$	58,802		$	58,697	
Ratio of net charge-offs (recoveries) to average net loans and leases outstanding		0.72	%		0.11	%		0.07	%		(0.11	)%		(0.04	)%
Ratio of reserve for loan and lease losses to net loans and leases outstanding end of period		2.85	%		2.42	%		2.09	%		2.18	%		2.38	%
Coverage ratio of reserve for loan and lease losses to non-performing loans and leases		104.84	%		212.30	%		592.49	%		374.75	%		349.45	%

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Net charge-offs (recoveries) as a percentage of average loans and leases by portfolio type follow:

	2009	2008	2007	2006	2005
Commercial and agricultural loans	0.95%	0.06%	(0.09)%	(0.12)%	0.04%
Auto, light truck and environmental equipment	0.73	(0.03)	0.40	(0.03)	(0.17)
Medium and heavy duty truck	0.93	0.25	0.16	(0.02)	(0.06)
Aircraft financing	1.09	(0.30)	(0.26)	(0.54)	0.04
Construction equipment financing	0.30	0.41	0.22	(0.24)	(0.51)
Loans secured by real estate	0.30	0.08	0.02	0.02	0.01
Consumer loans	1.63	1.44	0.88	0.74	0.41
Total net charge-offs (recoveries) to average portfolio loans and leases	0.72%	0.11%	0.07%	(0.11)%	(0.04)%

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 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, are as follows:

	2009		2008		2007		2006		2005	
(Dollars in thousands)	Reserve Amount	Percent of Loans and Leases in Each Category to Total Loans and Leases	Reserve Amount	Percent of Loans and Leases in Each Category to Total Loans and Leases	Reserve Amount	Percent of Loans and Leases in Each Category to Total Loans and Leases	Reserve Amount	Percent of Loans and Leases in Each Category to Total Loan and Leases	Reserve Amount	Percent of Loans and Leases in Each Category to Total Loans and Leases
Commercial and agricultural loans	$23,852	17.66 %	$23,025	19.51 %	$17,393	18.61 %	$14,547	17.70 %	$15,472	18.40 %
Auto, light truck, and environmental equipment	10,334	11.31	9,852	10.73	7,242	9.57	7,022	11.75	6,877	12.62
Medium and heavy duty truck	6,095	6.61	8,915	7.38	8,775	9.41	6,337	12.65	6,131	12.26
Aircraft financing	24,594	19.96	19,163	19.17	17,761	18.39	18,621	18.46	19,583	18.66
Construction equipment financing	8,839	10.13	10,672	11.40	6,171	11.84	5,030	11.32	4,235	9.10
	11,162	30.78	4,602	27.85	6,320	27.62	4,672	23.40	4,058	24.40

Loans secured by real estate										
Consumer loans	3,360	3.55	3,547	3.96	2,940	4.56	2,573	4.72	2,341	4.56
Total	$88,236	100.00%	$79,776	100.00%	$66,602	100.00%	$58,802	100.00%	$58,697	100.00%

Nonperforming Assets — Nonperforming assets include nonaccrual loans, restructured loans not performing in accordance with modified terms, other real estate, former bank premises held for sale, 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 $101.01 million at December 31, 2009, compared to $44.17 million at December 31, 2008, and $18.48 million at December 31, 2007. Included in nonperforming loans were restructured loans that are not accruing interest of $2.63 million at December 31, 2009 and none at December 31, 2008. During 2009, interest income on nonaccrual loans and leases would have increased by approximately $5.17 million compared to $1.54 million in 2008 if these loans and leases had earned interest at their full contract rate.

Nonperforming assets at December 31, 2009 increased from December 31, 2008, mainly due to increases in nonaccrual loans and leases. The increase in nonaccrual loans and leases was spread among the various loan portfolios. The largest dollar increases during the most recent year occurred in the commercial and aircraft portfolios. As of December 31, 2009, the industry with the largest dollar exposure was with borrowers whose primary source of income was derived from commercial real estate. These loans totaled approximately $25.74 million which were comprised of $20.77 million secured by commercial real estate and included in loans secured by real estate and $4.98 million secured by aircraft and included in aircraft financing. We have limited exposure to commercial real estate. However, our borrowers with commercial real estate exposure, whether they be local real estate developers in our commercial portfolio or customers in our niche portfolios such as aircraft whose underlying business is dependent on developing, marketing and managing real estate properties, have suffered as a result of declining real estate values and minimal sales activity. Furthermore, aircraft values declined during 2009, increasing the risk in aircraft secured transactions. Medium and heavy duty trucks are also a large exposure area for us. Medium and heavy duty trucks non-accrual loans and leases increased to $11.62 million as of December 31, 2009, up from $7.80 million as of December 31, 2008. The trucking industry has suffered from overcapacity, underutilization, aging fleets and declining collateral values which are expected to remain weak through 2011.

As of December 31, 2008, we had $0.29 million of loans classified as troubled debt restructuring. There were no loans classified as troubled debt restructurings at December 31, 2009.

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Nonperforming assets at December 31 (Dollars in thousands)	2009	2008	2007	2006	2005
Loans past due over 90 days	$ 628	$ 1,022	$ 1,105	$ 116	$ 245
Nonaccrual loans and leases and restructured loans:					
Commercial and agricultural loans	7,953	5,399	1,597	1,768	3,701
Auto, light truck and environmental equipment	9,200	709	507	481	812
Medium and heavy duty truck	11,624	7,801	277	1,755	17
Aircraft financing	6,024	9,975	1,846	8,219	7,641
Construction equipment financing	7,218	1,934	1,196	853	2,513
Loans secured by real estate	41,387	9,147	3,581	2,214	1,475
Consumer loans	131	1,590	1,132	285	393
Total nonaccrual loans and leases and restructured loans	83,537	36,555	10,136	15,575	16,552
Total nonperforming loans and leases	84,165	37,577	11,241	15,691	16,797
Other real estate	4,039	1,381	783	800	960
Former bank premises held for sale	2,490	3,356	4,038	-	-
Repossessions:					
Commercial and agricultural loans	164	53	45	2	-
Auto, light truck and environmental equipment	336	226	183	178	128
Medium and heavy duty truck	-	1,248	54	-	-
Aircraft financing	9,391	16	1,850	300	4,073
Construction equipment financing	238	67	92	400	-
Consumer loans	36	59	67	95	83
Total repossessions	10,165	1,669	2,291	975	4,284
Operating leases	154	185	126	201	-
Total nonperforming assets	$ 101,013	$ 44,168	$ 18,479	$ 17,667	$ 22,041
Nonperforming loans and leases to loans and leases, net of unearned discount	2.72 %	1.14 %	0.35 %	0.58 %	0.68 %
Nonperforming assets to loans and leases and operating leases, net of unearned discount	3.15 %	1.30 %	0.56 %	0.64 %	0.87 %

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, 2009, we had $12.08 million 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, 2009, potential problem loans consisted of seven credit relationships. Weakness in these companies' operating performance has caused us to heighten attention given to these credits.

Foreign Outstandings — Our foreign loan and lease outstandings denominated in U.S. dollars were $131.18 million and $88.03 million as of December 31, 2009 and 2008, respectively. Foreign loans and leases are in aircraft financing. Loan and lease outstandings to borrowers in Brazil were $87.66 million and $54.52 million as of December 31, 2009 and 2008, respectively. Outstanding balances to borrowers in other countries were insignificant.

Investment Portfolio

The amortized cost of securities at year-end 2009 increased 24.89% from 2008, following a 7.80% decrease from year-end 2007 to year-end 2008. The amortized cost of securities at December 31, 2009 was $893.44 million or 19.67% of total assets, compared to $715.38 million or 16.02% of total assets at December 31, 2008. The increase in the investment portfolio in 2009 was due to the investment of excess funds as deposit outstandings increased and loan outstandings decreased.

The amortized cost of securities available-for-sale as of December 31 is summarized as follows:

(Dollars in thousands)	2009	2008	2007
U.S. Treasury and Federal agencies securities	$ 390,189	$ 293,461	$ 284,214
U.S. States and political subdivisions securities	188,706	198,640	258,260
Mortgage-backed securities - Federal agencies	286,415	207,954	199,382
Corporate debt securities	26,166	10,494	6,631
Foreign government securities	675	435	665
Marketable equity securities	1,288	4,396	26,770
Total investment securities available-for-sale	$ 893,439	$ 715,380	$ 775,922

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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, 2009, 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	$	20,004	0.92	%
1 – 5 years		228,239	2.60	
5 – 10 years		141,946	3.45	
Over 10 years		-	-	
Total U.S. Treasury and Federal agencies securities		390,189	2.83	
U.S. States and political subdivisions securities				
Under 1 year		35,466	4.49	
1 – 5 years		78,590	5.48	
5 – 10 years		58,817	5.64	
Over 10 years		15,833	1.26	
Total U.S. States and political subdivisions securities		188,706	4.99	
Corporate debt securities				
Under 1 year		10,996	1.28	
1 – 5 years		15,170	1.82	
5 – 10 years		-	-	
Over 10 years		-	-	
Total Corporate debt securities		26,166	1.59	
Foreign government securities				
Under 1 year		100	4.05	
1 – 5 years		575	3.77	
5 – 10 years		-	-	
Over 10 years		-	-	
Total Foreign government securities		675	3.81	
Mortgage-backed securities - Federal agencies		286,415	3.97	
Marketable equity securities		1,288	9.45	
Total investment securities available-for-sale	$	893,439	3.62	%

Deposits

The average daily amounts of deposits and rates paid on such deposits are summarized as follows:

	2009				2008				2007			
(Dollars in thousands)		Amount	Rate			Amount	Rate			Amount	Rate	
Noninterest bearing demand deposits	$	427,513	-	%	$	377,440	-	%	$	351,050	-	%
Interest bearing demand deposits		1,209,800	0.62			1,137,491	1.82			988,308	3.10	
Savings deposits		325,801	0.29			285,538	0.63			250,927	1.21	
Other time deposits		1,610,534	3.42			1,573,801	4.09			1,679,521	4.85	
Total deposits	$	3,573,648			$	3,374,270			$	3,269,806		

See Part II, Item 8, Financial Statements and Supplementary Data — Note 10 of the Notes to Consolidated Financial

Statements for additional information on deposits.

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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 Security Repurchase Agreements	Commercial Paper	Other Short-Term Borrowings	Total Borrowings
2009				
Balance at December 31, 2009	$ 123,787	$ 4,726	$ 21,597	$ 150,110
Maximum amount outstanding at any month-end	275,407	5,392	23,863	304,662
Average amount outstanding	161,529	4,048	20,070	185,647
Weighted average interest rate during the year	0.40 %	0.34 %	2.30 %	0.60 %
Weighted average interest rate for outstanding amounts at December 31, 2009	0.25 %	0.43 %	1.80 %	0.48 %
2008				
Balance at December 31, 2008	$ 272,529	$ 4,461	$ 19,185	$ 296,175
Maximum amount outstanding at any month-end	359,452	9,875	247,828	617,155
Average amount outstanding	270,503	7,694	108,653	386,850
Weighted average interest rate during the year	1.97 %	2.35 %	1.95 %	1.97 %
Weighted average interest rate for outstanding amounts at December 31, 2008	0.49 %	0.29 %	2.92 %	0.65 %
2007				
Balance at December 31, 2007	$ 303,429	$ 10,783	$ 23,620	$ 337,832
Maximum amount outstanding at any month-end	327,623	15,478	42,784	385,885
Average amount outstanding	246,792	12,598	11,987	271,377
Weighted average interest rate during the year	3.92 %	4.84 %	5.49 %	4.03 %
Weighted average interest rate for outstanding amounts at December 31, 2007	2.98 %	4.04 %	2.60 %	2.99 %

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 of $100,000 and over. In 2009, average core deposits equaled 68.13% of average total assets, compared to 66.31% in 2008 and 67.12% in 2007. The effective cost rate of core deposits in 2009 was 1.54%, compared to 2.36% in 2008 and 3.25% in 2007.

Average demand deposits (noninterest bearing core deposits) increased 13.27% in 2009 compared to an increase of 7.52% in 2008. These represented 13.93% of total core deposits in 2009, compared to 12.93% in 2008, and 12.60% in 2007.

Purchased Funds — We use purchased funds to supplement core deposits, which include certain certificates of deposit of $100,000 and over, 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 2009, our reliance on purchased funds decreased to 15.30% of average total assets from 19.16% in 2008.

Shareholders’ Equity — Average shareholders’ equity equated to 12.57% of average total assets in 2009 compared to 10.09% in 2008. Shareholders’ equity was 12.56% of total assets at year-end 2009, compared to 10.16% at year-end 2008. 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 $5.09 million and $5.82 million at December 31, 2009 and 2008, respectively.

Our sale of preferred shares under the TARP Capital Purchase Program in January 2009 increased our shareholders' equity by $111.00 million. Our company plans to repay the TARP funding when the national economic conditions and their impact on our markets stabilize. The company maintains the cash and the capital necessary to pay the TARP back once we are sure there is a sustainable recovery and a low likelihood of another downward trend in the economy.

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.

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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 and Federal Home Loan Bank.

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 occasionally 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 earnings was modeled by calculating an immediate 100 basis point (1.00%) change in interest rates across all maturities. At December 31, 2009, the aggregate hypothetical increase in pre-tax earnings was estimated to be $3.38 million on an annualized basis on all rate-sensitive financial instruments, based on a hypothetical increase of a 100 basis point change in interest rates and the aggregate hypothetical decrease in pre-tax earnings was estimated to be $6.67 million on an annualized basis on all rate-sensitive financial instruments based on a hypothetical decrease of a 100 basis point change in interest rates. At December 31, 2008, the aggregate hypothetical increase in pre-tax earnings was estimated to be $2.95 million on an annualized basis on all rate-sensitive financial instruments, based on a hypothetical increase of a 100 basis point change in interest rates and the aggregate hypothetical decrease in pre-tax earnings was estimated to be $9.94 million on an annualized basis on all rate-sensitive financial instruments based on a hypothetical decrease of a 100 basis point change in interest rates. 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, 2009 and 2008, 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 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, 2009, 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.

Contractual obligation payments by period follows:

(Dollars in thousands)	Note	0 – 1 Year	1 – 3 Years	3 – 5 Years	Over 5 Years	Indeterminate maturity	Total
	-	$ 2,167,087	$ -	$ -	$ -	$ -	$ 2,167,087

Deposits without stated maturity							
Certificates of deposit	-	1,006,850	362,101	102,175	14,251	-	1,485,377
Long-term debt	11	10,317	265	105	873	8,201	19,761
Subordinated notes	12	-	-	-	89,692	-	89,692
Operating leases	18	2,597	3,504	1,055	1,144	-	8,300
Purchase obligations	-	16,562	2,817	11	-	-	19,390
Total contractual obligations		$ 3,203,413	$ 368,687	$ 103,346	$ 105,960	$ 8,201	$ 3,789,607

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, 2009. 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 2009. In 2009, we incurred new long-term obligations under our preferred shares issued under the TARP Capital Purchase Program. See Part II, Item 8, Financial Statements and Supplementary Data —Note 13 of the Notes to Consolidated Financial Statements.

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 change daily as market interest rates change. Because the derivative assets and liabilities recorded on the balance sheet at December 31, 2009 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.

In addition, due to the uncertainty with respect to the timing of future cash flows associated the with our unrecognized tax benefits at December 31, 2009, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, $1.85 million of unrecognized tax benefits have been excluded from the contractual obligations table above. See Note 17 of the Notes to Consolidated Financial Statements for a discussion on income taxes.

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.

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Quarterly Results of Operations

The following table sets forth unaudited consolidated selected quarterly statement of operations data for the years ended December 31, 2009 and 2008.

Three Months Ended (Dollars in thousands, except per share amounts)	March 31	June 30	September 30	December 31
2009				
Interest income	$ 50,676	$ 50,630	$ 49,741	$ 49,365
Interest expense	19,954	18,717	17,695	15,834
Net interest income	30,722	31,913	32,046	33,531
Provision for loan and lease losses	7,785	8,487	6,469	8,360
Investment securities and other investment (losses) gains	(469)	426	716	1,014
Income before income taxes	4,846	8,782	9,263	8,627
Net income	6,251	6,283	6,733	6,223
Net income available to common shareholders	4,938	4,587	5,032	4,517
Diluted net income per common share	0.20	0.19	0.21	0.19
2008				
Interest income	$ 62,124	$ 58,579	$ 58,065	$ 56,540
Interest expense	29,827	25,455	24,668	23,198
Net interest income	32,297	33,124	33,397	33,342
Provision for loan and lease losses	1,539	4,493	3,571	7,045
Investment securities and other investment gains (losses)	623	(1,066)	(8,816)	(738)
Income before income taxes	13,884	10,603	3,889	18,025
Net income	9,354	7,245	4,472	12,315
Net income available to common shareholders	9,354	7,245	4,472	12,315
Diluted net income per common share	0.38	0.30	0.18	0.50

Net income was $6.22 million for the fourth quarter of 2009, compared to the $12.32 million of net income reported for the fourth quarter of 2008. The 2008 fourth quarter net income was positively impacted by the sale of certain assets of 1st Source Corporation Investment Advisors to Wasatch Advisors, Inc. which resulted in an $11.49 million pre-tax (after-tax $7.14 million) gain. Diluted net income per common share for the fourth quarter of 2009 amounted to $0.19, compared to $0.50 per common share reported in the fourth quarter of 2008.

The net interest margin was 3.27% for the fourth quarter of 2009 versus 3.30% for the same period in 2008. Tax-equivalent net interest income was $34.49 million for the fourth quarter of 2009, up slightly from 2008's fourth quarter.

Our provision for loan and lease losses was $8.36 million in the fourth quarter of 2009 compared to provision for loan and lease losses of $7.05 million in the fourth quarter of 2008. Net charge-offs were $5.63 million for the fourth quarter 2009, compared to net charge-offs of $2.88 million a year ago.

Noninterest income for the fourth quarter of 2009 was $22.02 million, compared to $30.23 million for the fourth quarter of 2008. The predominate factor causing the decrease was the sale of certain assets of Investment Advisors for a gain of $11.49 million in the fourth quarter 2008. This decrease was offset by an increase in investment securities and other investment gains and mortgage banking income. Noninterest expense for the fourth quarter of 2009 was $38.56 million and was relatively unchanged compared to the fourth quarter of 2008.

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.

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Item 8. Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of 1st Source Corporation

We have audited 1st Source Corporation's internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). 1st Source Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's 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, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and 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, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of 1st Source Corporation as of December 31, 2009 and 2008, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2009 and our report dated February 19, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 19, 2010

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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 and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. 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 and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), 1st Source Corporation's internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 19, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 19, 2010

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CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

December 31 (Dollars in thousands)	2009	2008
ASSETS		
Cash and due from banks	$ 72,872	$ 119,771
Federal funds sold and interest bearing deposits with other banks	141,166	6,951
Investment securities available-for-sale (amortized cost of $893,439 and $715,380 at December 31, 2009 and December 31, 2008, respectively)	901,638	724,754
Other investments	21,012	18,612
Trading account securities	125	100
Mortgages held for sale	26,649	46,686
Loans and leases, net of unearned discount:		
Commercial and agricultural loans	546,222	643,440
Auto, light truck and environmental equipment	349,741	353,838
Medium and heavy duty truck	204,545	243,375
Aircraft financing	617,384	632,121
Construction equipment financing	313,300	375,983
Loans secured by real estate	952,223	918,749
Consumer loans	109,735	130,706
Total loans and leases	3,093,150	3,298,212

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