1ST SOURCE CORP
Form 10-K
February 20, 2009

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, 2008

OR

r 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

1 ST 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-wihout 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 r

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 r No x

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2008 was $218,217,564

The number of shares outstanding of each of the registrant's classes of stock as of February 16, 2009:
Common Stock, without par value — 24,176,342 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the annual proxy statement for the 2009 annual meeting of shareholders to be held April 23, 2009, are incorporated by reference into Part III.

-1-

table of contents

TABLE OF CONTENTS

Part I		
Item 1.	Business	3
Item 1A.	Risk Factors	7
Item 1B.	Unresolved Staff Comments	10
Item 2.	Properties	10
Item 3.	Legal Proceedings	10
Item 4.	Submission of Matters to a Vote of Security Holders	10
Part II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	10
Item 6.	Selected Financial Data	11
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	11
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	26
Item 8	Financial Statements and Supplementary Data	26
	Reports of Independent Registered Public Accounting Firm	26
	Consolidated Statements of Financial Condition	28
	Consolidated Statements of Income	29
	Consolidated Statements of Shareholders’ Equity	30
	Consolidated Statements of Cash Flow	31
	Notes to Consolidated Financial Statements	32
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	51
Item 9A.	Controls and Procedures	51
Item 9B.	Other Information	51
Part III		
Item 10.	Directors, Executive Officers and Corporate Governance	51
Item 11.	Executive Compensation	51
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	51
Item 13.	Certain Relationships and Related Transactions, and Director Independence	52
Item 14.	Principal Accounting Fees and Services	52
Part IV		
Item 15.	Exhibits, Financial Statement Schedules	52
Signatures		54
Exhibit 23		
Exhibit 31.1		
Exhibit 31.2		

Exhibit 32.1
Exhibit 32.2

---

table of contents

Part I

Item 1. Business.

1st Source Corporation

1st Source Corporation, an Indiana corporation incorporated in 1971, is a bank holding company headquartered in South Bend, Indiana that provides, through 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 79 banking center locations in 17 counties in Indiana and Michigan. 1st Source Bank's Specialty Finance Group, with 24 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 enjoy serving a very diverse client base. We are not dependent upon any single industry or client. At December 31, 2008, we had consolidated total assets of $4.46 billion, loans and leases of $3.30 billion, deposits of $3.51 billion, and total shareholders' equity of $453.66 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 Exchange Commission (SEC). We will provide a printed copy of any of the aforementioned documents to any requesting shareholder.

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, and light truck rental and leasing companies. The auto and light truck finance receivables generally range from $50,000 to $15 million with fixed or variable interest rates and terms of two to seven 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 $15 million with fixed or variable interest rates and terms of two 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 $50,000 to $15 million with fixed or variable interest rates and terms of two 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, and air cargo carriers. We have selectively entered the business aircraft markets of Brazil, Canada and Mexico on a limited basis where desirable aircraft financing opportunities exist. Aircraft finance receivables generally range from $250,000 to $15 million with fixed or variable interest rates and terms of two to fifteen 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 $15 million with fixed or variable interest rates and terms of three to seven years.

We also generate equipment rental income through the leasing of construction equipment, 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 Equipment Leasing, 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. On June 9, 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.

table of contents

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 Advisors is registered as an investment advisor with the Securities and Exchange Commission under the Investment Advisors Act of 1940. Investment Advisors serves strictly in an advisory capacity and, as such, does not hold any client securities.

Other Consolidated Subsidiaries

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

1st Source 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 match us against 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, 2008, we had approximately 1,280 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.

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

table of contents

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, 2008, 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 recent problems facing the financial markets and the economy, the Federal Deposit Insurance Corporation published a restoration plan designed to replenish the Deposit Insurance Fund over a period of five years and to increase the deposit insurance reserve ratio. On December 16, 2008, the FDIC adopted a final rule increasing risk-based assessment rates uniformly by 7 basis points, on an annual basis, for the first quarter 2009. The FDIC indicated that it will issue another final rule early in 2009, to take effect on April 1, 2009, to change the way that the FDIC's assessment system differentiates for risk, make corresponding changes to assessment rates beginning with the second quarter of 2009, and make certain technical and other changes to the assessment rules.

Temporary Liquidity Guarantee Program — On November 21, 2008, the FDIC Board of Directors adopted a final rule implementing the Temporary Liquidity Guarantee Program (TLG Program). The TLG Program 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.

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, 2009.

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.

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-

table of contents

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 R 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.

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 $10.30 million and up to $44.40 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 $44.40 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.

table of contents

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. We cannot predict whether or in what form any proposals will be adopted 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

table of contents

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.

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 continued 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.

table of contents

Economic conditions and current levels of market volatility are unprecedented — 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.

The capital and credit markets have been experiencing extreme volatility and disruption for more than 12 months. The volatility and disruption have reached unprecedented levels. In some cases, the markets have exerted downward pressure on stock prices, security prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength. If the current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience adverse effects, which may be material, on our ability to access capital and on our results of operations.

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.

Reliance 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.

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.

Impact of recently enacted legislation and our participation in the programs — 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 actual 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 continuation or 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 our 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 a five-year period, at any time that the reserve ratio falls below 1.15%. The recent failures of a large financial institution and several smaller ones have significantly increased the Deposit Insurance Fund's loss provisions, resulting in a decline in the reserve ratio to 1.01% as of June 30, 2008, 18 basis points below the reserve ratio as of March 31, 2008. 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.

On October 7, 2008, the FDIC released a five-year recapitalization plan and a proposal to raise premiums to recapitalize the fund. In order to implement the restoration plan, the FDIC proposed to change both its risk-based assessment system and its base assessment rates. Assessment rates would increase by seven basis points across the range of risk weightings. In December 2008, the FDIC adopted its rule, uniformly increasing the risk-based assessment rates by seven basis points, annually, resulting in a range of risk-based assessment of 12 basis points to 50 basis points. Changes to the risk-based assessment system would include increasing premiums for institutions that rely on excessive amounts of brokered deposits, increasing premiums for excessive use of secured liabilities, and lowering premiums for smaller institutions with very high capital levels.

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

table of contents

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, 2008, we also owned property and/or buildings on which 55 of the 1st Source Bank's 79 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, training facility, 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

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.

	2008 Sales Price		Cash Dividends	2007 Sales Price		Cash Dividends
Common Stock Prices (quarter ended)	High	Low	Paid	High	Low	Paid
March 31	$ 21.81	$ 15.13	$ .14	$ 32.62	$ 24.27	$ .14
June 30	22.62	16.10	.14	27.92	23.32	.14
September 30	30.00	14.54	.14	27.00	18.41	.14
December 31	25.56	12.61	.16	24.47	16.28	.14

As of December 31, 2008, there were 1,012 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, 2003, 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 59 banking companies in Indiana, Michigan, Ohio, and Wisconsin.

NOTE: Total return assumes reinvestment of dividends.

table of contents

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 552,552 shares. No shares were repurchased during the three months ended December 31, 2008.

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 R 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 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)	2008	2007 (2)	2006	2005	2004
Interest income	$ 235,308	$ 253,587	$ 208,994	$ 168,532	$ 151,437
Interest expense	103,148	134,677	102,561	70,104	52,749
Net interest income	132,160	118,910	106,433	98,428	98,688
Provision for (recovery of) loan and lease losses	16,648	7,534	(2,736)	(5,855)	229
Net interest income after provision for (recovery of) loan and lease losses	115,512	111,376	109,169	104,283	98,459
Noninterest income	84,003	70,619	76,585	68,533	62,733
Noninterest expense	153,114	140,312	126,211	123,439	127,091
Income before income taxes	46,401	41,683	59,543	49,377	34,101
Income taxes	13,015	11,144	20,246	15,626	9,136
Net income	$ 33,386	$ 30,539	$ 39,297	$ 33,751	$ 24,965
Assets at year-end	$ 4,464,174	$ 4,447,104	$ 3,807,315	$ 3,511,277	$ 3,563,715
Long-term debt and mandatorily redeemable securities at year-end	29,832	34,702	43,761	23,237	17,964
Shareholders’ equity at year-end	453,664	430,504	368,904	345,576	326,600
Basic net income per common share (1)	1.38	1.30	1.74	1.48	1.10
Diluted net income per common share (1)	1.37	1.28	1.72	1.46	1.08

Cash dividends per common share (1)	.580	.560	.534	.445	.382
Dividend payout ratio	42.34%	43.75%	31.05%	30.48%	35.37%
Return on average assets	0.76%	0.74%	1.11%	1.00%	0.75%
Return on average common equity	7.52%	7.47%	10.98%	10.12%	7.81%
Average common equity to average assets	10.09%	9.85%	10.07%	9.89%	9.55%

(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. Refer to Note C 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.

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-

table of contents

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. The forward-looking statements are based on our expectations and are subject to a number of risks and uncertainties.

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 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 A (Note A), 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 the valuation of securities. 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.

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 A 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,

table of contents

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. SFAS No. 157, Fair Value Measurements 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 A under the heading "Fair Value Measurements" and in Note S, "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 the initial capitalized amount, net of accumulated amortization, 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 A under the heading "Mortgage Banking Activities."

Recent Market Developments

The global and U.S. economies are experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system during the past year. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of residential-related loans and mortgage-backed securities, but spreading to credit default swaps and other derivative securities, have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.

Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions. The availability of credit, confidence in the financial sector, and level of volatility in the

financial markets have been significantly adversely affected as a result. In recent months, volatility and disruption in the capital and credit markets have reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength.

In response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, the Emergency Economic Stabilization Act of 2008 ("EESA") was signed into law on October 3, 2008. The EESA authorizes the Treasury to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. The EESA also provided a temporary increase in deposit insurance coverage from $100,000 to $250,000 per insured account until December 31, 2009.

On October 14, 2008, Secretary Paulson, after consulting with the Federal Reserve and the FDIC, announced that the Treasury will purchase equity stakes in certain banks and thrifts. Under this program, known as the Troubled Asset Relief Program Capital Purchase Program (the "TARP Capital Purchase Program"), the Treasury will make $250 billion of capital available to U.S. financial institutions in the form of preferred stock (from the $700 billion authorized by the EESA). In conjunction with the purchase of preferred stock, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions will be required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program.

Also on October 14, 2008, after receiving a recommendation from the boards of the FDIC and the Federal Reserve, and consulting with the President, Secretary Paulson signed the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior unsecured debt of all FDIC-insured institutions and their holding companies, as well as deposits in noninterest-bearing transaction deposit accounts under a Temporary Liquidity Guarantee Program through December 31, 2009. All insured depository institutions automatically participated in the Temporary Liquidity Guarantee Program for 30 days following the announcement of the program without charge (subsequently extended to December 5, 2008) and thereafter, unless an institution opted out, at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for noninterest-bearing transaction deposits.

1st Source elected to participate in the TARP Capital Purchase Program, and on January 23, 2009 received $111.00 million in additional capital through the program. In exchange, the Treasury received a like amount of 1st Source Corporation preferred stock that pays an annual dividend of 5.00 percent for the first five years, and an annual dividend of 9.00 percent in any years thereafter. We may redeem the preferred shares issued to Treasury in full during the first three years following issuance only with the proceeds of a qualifying equity offering. Thereafter, the preferred shares may be redeemed in full or in part at any time. We also issued a warrant to the Treasury to purchase 837,947 shares of 1st Source common stock, which, upon issuance, would represent approximately 3.3 percent of our outstanding common shares, based upon current information. The warrant is exercisable at any time during the ten-year period following issuance at an exercise price of $19.87.

Notwithstanding the foregoing, The American Recovery and Reinvestment Act of 2009 ("ARRA"), which was signed into law by President Obama on February 17, 2009, provides that the Secretary of the Treasury shall permit a recipient of funds under the Troubled Assets Relief Program, subject to consultation with the recipient's appropriate Federal banking agency, to repay such assistance without regard to whether the recipient has replaced such funds from any other source or to any waiting period. ARRA further provides that when the recipient repays such assistance, the Secretary of the Treasury shall liquidate the warrants associated with the assistance at the current market price. While Treasury has not yet issued implementing regulations, it appears that ARRA will permit 1st Source, if it so elects and following consultation with the FRB, to redeem the Series A Preferred Stock at any time without restriction.

Additionally, 1st Source has decided to continue to participate in the Temporary Liquidity Guarantee Program following the expiration of the initial opt-out period. Our participation includes both the Transaction Account Guarantee Program related to the guarantee of noninterest bearing deposit accounts and eligible, low earning NOW accounts (interest rate equal to or less than 0.50%) and the Debt Guarantee Program related to the guarantee of applicable senior unsecured debt.

table of contents

It is not clear at this time what impact the EESA, the TARP Capital Purchase Program, the Temporary Liquidity Guarantee Program, or other liquidity and funding initiatives will have on the financial markets and the other difficulties described above, including the high levels of volatility and limited credit availability currently being experienced, or on the U.S. banking and financial industries and the broader U.S. global economies. Further adverse effects could have an adverse effect on our business.

Earnings Summary

Net income in 2008 was $33.39 million, up from $30.54 million in 2007 and down from $39.30 million in 2006. Diluted net income per common share was in $1.37 in 2008, $1.28 in 2007, and $1.72 in 2006. Return on average total assets was 0.76% in 2008 compared to 0.74% in 2007, and 1.11% in 2006. Return on average common shareholders' equity was 7.52% in 2008 versus 7.47% in 2007, and 10.98% in 2006.

Net income in 2008 was favorably impacted by an 11.14% increase in net interest income over 2007, an $11.49 million gain on the sale of certain assets of Investment Advisors and increased noninterest income. These increases were offset by increased provision for loan and lease losses, investment securities impairment and increased noninterest expenses. Net income in 2007 was favorably affected by an 11.72% increase in net interest income over 2006. However, this increase was more than offset by an increase in the provision for loan and lease losses, decreased mortgage banking income, investment securities impairment and increased noninterest expenses.

Dividends paid on common stock in 2008 amounted to $0.58 per share, compared to $0.56 per share in 2007, and $0.534 per share in 2006. 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.

Upgrade of Core Systems — During 2007, we upgraded a majority of our core and ancillary data processing systems. Numerous internal teams were formed to manage the installation and conversion of data and various systems. The core technology includes a loan system, deposit system, general ledger system, and customer information file system. Additionally, ATM networks, a voice response unit (VRU) system, and document imaging systems were installed. Total 2007 expenses for this upgrade were $2.71 million.

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 3.34% in 2008 compared to 3.18% in 2007, and 3.29% in 2006. The higher margin in

2008 reflects lower funding costs compared with the decline in yields on earning assets. Net interest income was $132.16 million for 2008, compared to $118.91 million for 2007. Tax-equivalent net interest income totaled $135.75 million for 2008, an increase of $13.22 million from the $122.53 million reported for 2007. The $13.22 million increase is mainly due to changes in rates.

During 2008, average earning assets increased $215.89 million while average interest-bearing liabilities increased $194.30 million over the comparable period. The yield on average earning assets decreased 81 basis points to 5.87% for 2008 from 6.68% for 2007. The rate earned on assets was negatively impacted by decreases in market rates. Total cost of average interest-bearing liabilities decreased 112 basis points during 2008 as liabilities were also impacted by decreases in market rates. The result was an increase of 31 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 2008 was the 97 basis point decrease in the loan and lease portfolio yield. The decrease in the loan and lease portfolio yield was offset by an increase in net loan and lease outstandings. Average net loans and leases increased $270.74 million or 9.05% in 2008 from 2007.

During 2008, the tax-equivalent yield on securities available for sale decreased 28 basis points to 4.60% while the average balance decreased $22.99 million.

Average interest-bearing deposits increased $78.07 million during 2008 while the effective rate paid on those deposits decreased 104 basis points. Average demand deposits increased $26.39 million during 2008.

Average short-term borrowings increased $115.47 million during 2008; however, the effective rate paid decreased 206 basis points. Average subordinated notes which represent our trust preferred borrowings increased $8.55 million during 2008, while the effective rate increased four basis points. Average long-term debt decreased $7.79 million during 2008 as the effective rate decreased 57 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.

table of contents

(Dollars in thousands)	2008 Average Balance	2008 Interest Income/Expense	2008 Yield/Rate	2007 Average Balance	2007 Interest Income/Expense	2007 Yield/Rate	2006 Average Balance	2006 Interest Income/Expense	2006 Yield/Rate
ASSETS									
Investment securities:									
Taxable	$ 491,061	$ 22,170	4.51%	$ 510,949	$ 25,136	4.92%	$ 458,152	$ 19,177	4.19%
Tax-exempt	222,751	10,692	4.80	225,849	10,800	4.78	173,652	7,416	4.27
Mortgages held for sale	33,925	2,069	6.10	28,913	1,892	6.54	53,034	3,549	6.69
Net loans and leases	3,263,276	202,539	6.21	2,992,540	214,725	7.18	2,566,217	178,125	6.94
Other investments	57,601	1,425	2.47	94,478	4,657	4.93	64,049	3,271	5.11
Total earning assets	4,068,614	238,895	5.87	3,852,729	257,210	6.68	3,315,104	211,538	6.38
Cash and due from banks	83,270			81,714			78,365		
Reserve for loan and lease losses	(71,358)			(61,555)			(59,082)		
Other assets	319,997			278,421			217,914		
Total assets	$ 4,400,523			$ 4,151,309			$ 3,552,301		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest bearing deposits	$ 2,996,830	$ 86,903	2.90%	$ 2,918,756	$ 115,113	3.94%	$ 2,418,344	$ 85,067	3.52%
Short-term borrowings	386,850	7,626	1.97	271,377	10,935	4.03	265,824	11,011	4.14
Subordinated notes	90,960	6,714	7.38	82,414	6,051	7.34	59,022	4,320	7.32
Long-term debt and mandatorily redeemable securities	34,472	1,905	5.53	42,265	2,578	6.10	36,952	2,163	5.85
Total interest bearing liabilities	3,509,112	103,148	2.94	3,314,812	134,677	4.06	2,780,142	102,561	3.69
Noninterest bearing deposits	377,440			351,050			352,204		
Other liabilities	69,823			76,472			62,196		
Shareholders' equity	444,148			408,975			357,759		
Total liabilities and	$ 4,400,523			$ 4,151,309			$ 3,552,301		

shareholders' equity			
Net interest income	$ 135,747	$ 122,533	$ 108,977
Net interest margin on a tax equivalent basis	3.34%	3.18%	3.29%

-15-

table of contents

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

	Increase (Decrease) due to		
(Dollars in thousands)	Volume	Rate	Net
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
2007 compared to 2006			
Interest earned on:			
Investment securities:			
Taxable	$ 2,383	$ 3,576	$ 5,959
Tax-exempt	2,422	962	3,384
Mortgages held for sale	(1,579)	(78)	(1,657)
Net loans and leases	30,264	6,336	36,600
Other investments	1,497	(111)	1,386
Total earning assets	$ 34,987	$ 10,685	$ 45,672
Interest paid on:			
Interest bearing deposits	$ 19,125	$ 10,921	$ 30,046
Short-term borrowings	241	(317)	(76)
Subordinated notes	1,719	12	1,731
Long-term debt and mandatorily redeemable securities	320	95	415
Total interest bearing liabilities	$ 21,405	$ 10,711	$ 32,116
Net interest income	$ 13,582	$ (26)	$ 13,556

Noninterest Income — Noninterest income increased 18.95% in 2008 from 2007 following a 7.79% decrease in 2007 over 2006. Noninterest income for the most recent three years ended December 31 was as follows:

(Dollars in thousands)	2008	2007	2006
Noninterest income:			
Trust fees	$ 18,599	$ 15,567	$ 13,806
Service charges on deposit accounts	22,035	20,470	19,040
Mortgage banking income	2,994	2,868	11,637
Insurance commissions	5,363	4,666	4,574
Equipment rental income	24,224	21,312	18,972

Other income	9,293	8,864	6,554
Gain on sale of certain Investment Advisor assets	11,492	-	-
Investment securities and other investment (losses) gains	(9,997)	(3,128)	2,002
Total noninterest income	$ 84,003	$ 70,619	$ 76,585

table of contents

Trust fees (which include investment management fees, estate administration fees, mutual fund fees, annuity fees, and fiduciary fees) increased by 19.48% in 2008 from 2007 compared to an increase of 12.76% in 2007 over 2006. Trust fees are largely based on the size of client relationships and the market value and mix of assets under management. The market value of trust assets under management at December 31, 2008 and 2007, was $2.65 billion and $3.05 billion, respectively. At December 31, 2008, these trust assets were comprised of $1.59 billion of personal and agency trusts, $0.64 billion of employee benefit plan assets, $314.02 million of estate administration assets and individual retirement accounts, and $98.05 million of custody assets. Growth in trust fees was mainly attributed to an increase in revenue sharing fees earned on the Monogram mutual funds sold outside the Bank and administered by the Investment Advisors subsidiary.

Service charges on deposit accounts increased 7.65% in 2008 from 2007 compared to an increase of 7.51% in 2007 from 2006. The growth in service charges on deposit accounts 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 4.39% in 2008 over 2007, compared to a decrease of 75.35% in 2007 over 2006. In 2008, increased gains on mortgage loan sales were offset by $1.91 million in mortgage servicing rights impairment. The decrease in 2007 was primarily due to a decline in production volume, non-recurring 2006 gains on the sale of mortgage servicing rights and a decline in loan servicing fee income. In 2006, we recognized $4.75 million in pre-tax gains on bulk sales of mortgage servicing rights related to both governmental and conventional loans that occurred during the second and third quarters. During 2008, 2007 and 2006, we determined that no permanent write-down was necessary for previously recorded impairment on mortgage servicing assets.

Insurance commissions were up 14.94% in 2008 from 2007 compared to an increase of 2.01% in 2007 from 2006. The increase for 2008 and 2007 was mainly attributed to an acquisition of an insurance agency in the Fort Wayne area. The increase for 2006 was mainly attributed to higher contingent commissions.

Equipment rental income generated from operating leases grew by 13.66% during 2008 from 2007 compared to an increase of 12.33% during 2007 from 2006. Revenues from operating leases for construction equipment, various trucks, and other equipment 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 losses totaled $10.00 million for the year ended 2008 compared to losses of $3.13 million for the year ended 2007 and gains of $2.00 million for the year ended 2006. 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. In 2008, deterioration in the residential mortgage business and government intervention at the FNMA and the FHLMC resulted in further impairment of the FNMA and the FHLMC securities. Due to the uncertainty of future market conditions and how they might impact the financial performance of the FNMA and the

FHLMC, we were unable to determine when or if this impairment will be recovered. As of December 31, 2008, the carrying value of our investment in the FHLMC preferred stock was $0.13 million and the carrying value of our investment in the FNMA preferred stock was $0.03 million. Favorable market valuation adjustments on our venture partnership investments during 2006 were the main factor contributing to the 2006 gains.

Other income remained relatively stable in 2008 from 2007 after an increase of 35.25% in 2007 compared to 2006. The increase in 2007 was primarily due to increases in interest rate swap fee income, credit card merchant fees, and income on bank owned life insurance policies.

Noninterest Expense — Noninterest expense increased 9.12% in 2008 over 2007 following an 11.17% increase in 2007 from 2006. Noninterest expense for the recent three years ended December 31 was as follows:

(Dollars in thousands)	2008	2007	2006
Noninterest expense:			
Salaries and employee benefits	$ 76,965	$ 73,944	$ 66,605
Net occupancy expense	9,698	9,030	7,492
Furniture and equipment expense	15,095	15,145	12,316
Depreciation — leased equipment	19,450	17,085	14,958
Professional fees	8,446	4,575	3,998
Supplies and communications	6,782	5,987	5,496
Business development and marketing expense	3,749	4,788	4,008
Intangible asset amortization	1,393	874	1,910
Loan and lease collection and repossession expense	1,162	1,123	704
Other expense	10,374	7,761	8,724
Total noninterest expense	$ 153,114	$ 140,312	$ 126,211

table of contents

Total salaries and employee benefits increased 4.09% in 2008 from 2007, following an 11.02% increase in 2007 from 2006.

Employee salaries increased 3.69% in 2008 from 2007 compared to an increase of 13.25% in 2007 from 2006. The increase in 2008 is due to a full year of First National staff and a decline in salaries deferred relating to the origination of loans (SFAS 91). The increase in 2007 is mainly attributable to a larger work force following the acquisition of First National and lower 2006 salaries due to the first quarter 2006 reversal of previously recognized stock-based compensation expense under historical accounting methods related to the estimated forfeiture of stock awards. This one-time expense reversal, combined with the adoption of Statement of Financial Accounting Standards No. 123(R), Share-based Payment, (SFAS No. 123(R)) estimated forfeiture accounting requirements, resulted in a reduction in stock-based compensation of $2.07 million, pre-tax, for the 2006 year.

Employee benefits increased 5.74% in 2008 from 2007 after remaining relatively stable in 2007 and 2006. The increase in 2008 was primarily due to increased group insurance costs.

Occupancy expense increased 7.40% in 2008 from 2007, compared to an increase of 20.53% in 2007 from 2006. The increase in 2008 and 2007 was primarily due to the increase in number of locations following the acquisition of First National.

Furniture and equipment expense, including depreciation, declined slightly in 2008 from 2007 compared to a 22.97% increase in 2007 from 2006. During 2008 increased computer processing charges offset declines in repairs and depreciation. During 2007, higher software costs, which were mostly related to implementation of upgrades to our core accounting and management systems, and higher debit card transaction expense were the significant factors contributing to the increase.

Depreciation on equipment owned under operating leases increased 13.84% in 2008 from 2007, following a 14.22% increase in 2007 from 2006. In 2008 and in 2007, 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 increased 84.61% in 2008 from 2007, compared to a 14.43% increase in 2007 from 2006. The increase in 2008 was due to expenses recorded for a systems security breach that occurred in May 2008 and other consulting expenses. The majority of the increase in 2007 was due to higher consulting fees paid in conjunction with our core system upgrade.

Supplies and communications expense increased 13.28% in 2008 from 2007 after an 8.93% increase in 2007 as compared to 2006. The increase in 2008 was due to increased printing cost, freight expense and data line expense. The increase in 2007 was due to increased telephone and data line expense and increased freight expense.

Business development and marketing expense decreased 21.70% in 2008 from 2007 compared to a 19.46% increase in 2007 from 2006. The decrease in 2008 was due to reduced retail marketing expenses. The increase in 2007 was mainly due to strong marketing across our entire footprint area.

Intangible asset amortization increased 59.38% in 2008 from 2007 compared to a 54.24% decrease in 2007 from 2006. The increase in intangible asset amortization for 2008 was due to the amortization of intangibles related to the First National acquisition. The decrease in intangible asset amortization for 2007 was primarily due to the effects of the complete amortization of assets associated with acquisitions which occurred during 2001.

Loan and lease collection and repossession expenses remained stable in 2008 from 2007 compared to a 59.52% increase in 2007 from 2006. The increase in 2007 was mainly due to increased collection and repossession legal activity.

Other expenses increased 33.67% in 2008 as compared to 2007 following a decrease of 11.04% in 2007 from 2006. Increased FDIC insurance expense, correspondent bank fees, and write-downs of former bank premises held for sale attributed to the 2008 increase.

Income Taxes — 1st Source recognized income tax expense in 2008 of $13.02 million, compared to $11.14 million in 2007, and $20.25 million in 2006. The effective tax rate in 2008 was 28.05% compared to 26.74% in 2007, and 34.00% in 2006. 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 O 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)	2008	2007	2006	2005	2004
Commercial and agricultural loans	$ 643,440	$ 593,806	$ 478,310	$ 453,197	$ 425,018
Auto, light truck and environmental equipment	353,838	305,238	317,604	310,786	263,637
Medium and heavy duty truck	243,375	300,469	341,744	302,137	267,834
Aircraft financing	632,121	587,022	498,914	459,645	444,481
Construction equipment financing	375,983	377,785	305,976	224,230	196,516
Loans secured by real estate	918,749	881,646	632,283	601,077	583,437
Consumer loans	130,706	145,475	127,706	112,359	99,245
Total loans and leases	$ 3,298,212	$ 3,191,441	$ 2,702,537	$ 2,463,431	$ 2,280,168

At December 31, 2008, 12.3% of total loans and leases were concentrated with construction end users.

Average loans and leases, net of unearned discount, increased 9.05% and 16.61% in 2008 and 2007, respectively. Loans and leases, net of unearned discount, at December 31, 2008, were $3.30 billion and were 73.88% of total assets, compared to $3.19 billion and 71.76% of total assets at December 31, 2007.

Commercial and agricultural lending, excluding those loans secured by real estate, increased 8.36% in 2008 over 2007. Commercial and agricultural lending outstandings were $643.44 million and $593.81 million at December 31, 2008 and December 31, 2007, respectively. This increase was mainly due to growth in our newer markets and strong business activity during the first half of 2008. Agricultural loan outstandings benefited from a robust market coupled with increased working capital needs attributed to higher commodity prices.

Loans secured by real estate increased 4.21% during 2008 over 2007. Loans secured by real estate outstanding at December 31, 2008, were $918.75 million

table of contents

and $881.65 million at December 31, 2007. Loans on commercial real estate, the majority of which is owner occupied, were $621.08 million at December 31, 2008 and $530.45 million at December 31, 2007. The increase was mostly due to growth in our newer markets and strong business activity during the first half of 2008. Residential mortgage lending was $344.36 million at December 31, 2008 and $351.20 million at December 31, 2007.

Auto, light truck, and environmental equipment financing increased 15.92% in 2008 over 2007. At December 31, 2008, auto, light truck, and environmental equipment financing had outstandings of $353.84 million and $305.24 million at December 31, 2007. Environmental equipment financing remained flat in 2008. Auto and light truck financing increased 24.00% at December 31, 2008 compared to December 31, 2007, mainly due to the elimination of our program with Vehicle Services of America which caused letters of credit to be funded, and to our competition leaving the market.

Medium and heavy duty truck loans and leases decreased 19.00%, in 2008. Medium and heavy duty truck financing at December 31, 2008 and 2007, had outstandings of $243.38 million and $300.47 million, respectively. Most of the decrease at December 31, 2008 from December 31, 2007 can be attributed to a reduced need for funding as clients downsized.

Aircraft financing at year-end 2008 increased 7.68% from year-end 2007. Aircraft financing at December 31, 2008 and 2007, had outstandings of $632.12 million and $587.02 million, respectively. The increase in 2008 was primarily due to focused sales efforts and a reduction in competition.

Construction equipment financing remained relatively stable in 2008 compared to 2007. Construction equipment financing at December 31, 2008, had outstandings of $375.98 million, compared to outstandings of $377.79 million at December 31, 2007.

Consumer loans decreased 10.15% in 2008 over 2007. Consumer loans outstanding at December 31, 2008, were $130.71 million and $145.48 million at December 31, 2007. The decrease during 2008 was due to the economic slow down caused an increase in the unemployment rates in our primary markets, thereby decreasing the number of credit worthy customers.

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, 2008. 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	$ 465,587	$ 177,655	$ 198	$ 643,440
Auto, light truck and environmental equipment	238,730	111,178	3,930	353,838
Medium and heavy duty truck	124,767	117,285	1,323	243,375
Aircraft financing	297,928	321,532	12,661	632,121
Construction equipment financing	176,238	199,180	565	375,983
Total	$ 1,303,250	$ 926,830	$ 18,677	$ 2,248,757

Rate Sensitivity (Dollars in thousands)	Fixed Rate	Variable Rate	Total
1 – 5 Years	$ 639,869	$ 286,961	$ 926,830
Over 5 Years	5,723	12,954	18,677
Total	$ 645,592	$ 299,915	$ 945,507

Most of the Bank's residential mortgages are sold into the secondary market. Mortgage loans held for sale were $46.69 million at December 31, 2008 and were $25.92 million at December 31, 2007.

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 A 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.

The reserve for loan and lease losses at December 31, 2008 totaled $79.78 million and was 2.42% of loans and leases, compared to $66.60 million or 2.09% of loans and leases at December 31, 2007 and $58.80 million or 2.18% of loans and leases at December 31, 2006. 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, 2008.

The provision for loan and lease losses was $16.65 million for 2008, compared to the provision for loan and lease losses of $7.53 million for 2007 and the recovery of provision for loan and lease losses of $2.74 million for 2006. The increased provision for loan and lease losses in 2008 was due to the deterioration in the loan portfolio mainly due to the deterioration in the economy. The recovery of the provision for 2006 was due to increased loan recoveries and was consistent with our improved credit quality of the loan and lease portfolio.

table of contents

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

(Dollars in thousands)	2008	2007	2006	2005	2004
Amounts of loans and leases outstanding at end of period	$ 3,298,212	$ 3,191,441	$ 2,702,537	$ 2,463,431	$ 2,280,168
Average amount of net loans and leases outstanding during period	$ 3,263,276	$ 2,992,540	$ 2,566,217	$ 2,348,690	$ 2,240,055
Balance of reserve for loan and lease losses at beginning of period	$ 66,602	$ 58,802	$ 58,697	$ 63,672	$ 70,045
Charge-offs:					
Commercial and agricultural loans	1,580	1,841	1,038	1,478	6,104
Auto, light truck and environmental equipment	234	1,770	340	630	2,408
Medium and heavy duty truck	924	569	-	15	352
Aircraft financing	462	378	1,126	2,424	3,585
Construction equipment financing	1,695	799	118	-	686
Loans secured by real estate	879	356	129	167	456
Consumer loans	2,619	1,654	1,203	858	1,090
Total charge-offs	8,393	7,367	3,954	5,572	14,681
Recoveries:					
Commercial and agricultural loans	1,177	2,356	1,594	1,308	1,312
Auto, light truck and environmental equipment	330	446	430	1,140	1,277
Medium and heavy duty truck	248	64	59	174	14
Aircraft financing	2,230	1,779	3,612	2,255	4,460
Construction equipment financing	139	19	753	1,065	547
Loans secured by real estate	171	169	31	89	107
Consumer loans	624	421	316	421	362
Total recoveries	4,919	5,254	6,795	6,452	8,079
Net charge-offs (recoveries)	3,474	2,113	(2,841)	(880)	6,602
Provision for (recovery of provision for) loan and lease losses	16,648	7,534	(2,736)	(5,855)	229
Reserves acquired in acquisitions	-	2,379	-	-	-
Balance at end of period	$ 79,776	$ 66,602	$ 58,802	$ 58,697	$ 63,672
Ratio of net charge-offs (recoveries) to average net loans and leases outstanding	0.11%	0.07%	(0.11) %	(0.04) %	0.29%

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

	2008	2007	2006	2005	2004
Commercial and agricultural loans	0.06%	(0.09) %	(0.12) %	0.04%	1.14%
Auto, light truck and environmental equipment	(0.03)	0.40	(0.03)	(0.17)	0.43
Medium and heavy duty truck	0.25	0.16	(0.02)	(0.06)	0.14
Aircraft financing	(0.30)	(0.26)	(0.54)	0.04	(0.19)
Construction equipment financing	0.41	0.22	(0.24)	(0.51)	0.07
Loans secured by real estate	0.08	0.02	0.02	0.01	0.06
Consumer loans	1.44	0.88	0.74	0.41	0.77
Total net charge-offs (recoveries) to average portfolio loans and leases	0.11%	0.07%	(0.11) %	(0.04) %	0.29%

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 (for purposes of this analysis, auto, light truck and environmental equipment and medium and heavy duty truck loans and leases have been consolidated into the category truck and automobile financing):

table of contents

(Dollars in thousands)	2008 Reserve Amount	2008 Percent of Loans and Leases in Each Category to Total Loans and Leases	2007 Reserve Amount	2007 Percent of Loans and Leases in Each Category to Total Loans and Leases	2006 Reserve Amount	2006 Percent of Loans and Leases in Each Category to Total Loans and Leases	2005 Reserve Amount	2005 Percent of Loans and Leases in Each Category to Total Loan and Leases	2004 Reserve Amount	2004 Percent of Loans and Leases in Each Category to Total Loans and Leases
Commercial and agricultural loans	$ 23,025	19.51%	$ 17,393	18.61%	$ 14,547	17.70%	$ 15,472	18.40%	$ 13,612	18.64%
Auto, light truck, and environmental equipment	9,852	10.73	7,242	9.57	7,022	11.75	6,877	12.62	7,933	11.56
Medium and heavy duty truck	8,915	7.38	8,775	9.41	6,337	12.65	6,131	12.26	4,700	11.75
Aircraft financing	19,163	19.17	17,761	18.39	18,621	18.46	19,583	18.66	26,475	19.49
Construction equipment financing	10,672	11.40	6,171	11.84	5,030	11.32	4,235	9.10	4,502	8.62
Loans secured by real estate	4,602	27.85	6,320	27.62	4,672	23.40	4,058	24.40	4,187	25.59
Consumer loans	3,547	3.96	2,940	4.56	2,573	4.72	2,341	4.56	2,263	4.35
Total	$ 79,776	100.00%	$ 66,602	100.00%	$ 58,802	100.00%	$ 58,697	100.00%	$ 63,672	100.00%

Nonperforming Assets — 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 $44.17 million at December 31, 2008, compared to $18.48 million at December 31, 2007, and $17.67 million at December 31, 2006. Impaired loans and leases totaled $30.94 million, $6.19 million, and $12.32 million at December 31, 2008, 2007, and 2006, respectively. During 2008, interest income that would have been recorded on nonaccrual loans and leases under their original terms was $1.54 million, compared to $0.98 million in 2007.

Nonperforming assets at December 31, 2008 increased from December 31, 2007, mainly due to increases in nonaccrual loans. Nonaccrual loans increased in all categories with the largest increases coming in aircraft financing, medium and heavy duty truck loans, loans secured by real estate and commercial and agricultural loans.

Nonperforming assets at December 31 (Dollars in thousands)	2008	2007	2006	2005	2004
Loans past due over 90 days	$ 1,022	$ 1,105	$ 116	$ 245	$ 481
Nonaccrual loans and leases and restructured loans:					
Commercial and agricultural loans	5,399	1,597	1,768	3,701	6,928
Auto, light truck and environmental equipment	709	507	481	812	2,336
Medium and heavy duty truck	7,801	277	1,755	17	179
Aircraft financing	9,975	1,846	8,219	7,641	10,132
Construction equipment financing	1,934	1,196	853	2,513	4,097
Loans secured by real estate	9,147	3,581	2,214	1,475	1,141
Consumer loans	1,590	1,132	285	393	440
Total nonaccrual loans and leases and restructured loans	36,555	10,136	15,575	16,552	25,253
Total nonperforming loans and leases	37,577	11,241	15,691	16,797	25,734
Other real estate	1,381	783	800	960	1,307
Former bank premises held for sale	3,356	4,038	-	-	-
Repossessions:					
Commercial and agricultural loans	53	45	2	-	-
Auto, light truck and environmental equipment	226	183	178	128	1,112
Medium and heavy duty truck	1,248	54	-	-	-
Aircraft financing	16	1,850	300	4,073	3,037
Construction equipment financing	67	92	400	-	183
Consumer loans	59	67	95	83	50
Total repossessions	1,669	2,291	975	4,284	4,382
Operating leases	185	126	201	-	1,785
Total nonperforming assets	$ 44,168	$ 18,479	$ 17,667	$ 22,041	$ 33,208
Nonperforming loans and leases to loans and leases, net of unearned discount	1.14%	0.35%	0.58%	0.68%	1.13%
Nonperforming assets to loans and leases and operating leases, net of unearned discount	1.30%	0.56%	0.64%	0.87%	1.42%

table of contents

At December 31, 2008, our management was not aware of any potential problem loans or leases that would have a material effect on loan and lease delinquency or loan and lease charge-offs. Loans and leases are subject to continual review and are given management's attention whenever a problem situation appears to be developing. While we are hopeful the new President and his cabinet will be able to stabilize capital and financial markets allowing some normality to return to the economy leading to higher employment and positive impacts, we expect further deterioration in the loan and lease portfolio.

Investment Portfolio

The amortized cost of securities at year-end 2008 decreased 7.80% from 2007, following an 11.02% increase from year-end 2006 to year-end 2007. The amortized cost of securities at December 31, 2008 was $715.38 million or 16.02% of total assets, compared to $775.92 million or 17.45% of total assets at December 31, 2007. Subsequent to year-end 2008, we sold $111.00 million in preferred shares under the TARP Capital Purchase Program. To replenish the investment portfolio, we have invested the proceeds of this transaction for the time being in investment securities, which has increased our investment portfolio.

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

(Dollars in thousands)	2008	2007	2006
U.S. Treasury and government agencies, including agency mortgage-backed securities	$ 501,415	$ 483,596	$ 466,326
States and political subdivisions	198,640	258,260	182,356
Other securities	15,325	34,066	50,197
Total investment securities available-for-sale	$ 715,380	$ 775,922	$ 698,879

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, 2008, at the amortized costs and weighted average yields of such securities:

(Dollars in thousands)	Amount	Yield
U.S. Treasury and government agencies, including agency mortgage-backed securities		
Under 1 year	$ 172,205	1.87 %
1 – 5 years	76,698	4.50
5 – 10 years	80,674	4.88
Over 10 years	171,838	4.30
Total U.S. Treasury and government agencies, including agency mortgage-backed securities	501,415	3.59
States and political subdivisions		
Under 1 year	42,475	4.37
1 – 5 years	81,917	5.18
5 – 10 years	54,904	5.53
Over 10 years	19,344	3.71
Total states and political subdivisions	198,640	4.96
Other securities		
Under 1 year	160	4.21
1 – 5 years	10,769	2.33
5 – 10 years	-	-
Over 10 years	-	-

Marketable equity securities		4,396	8.38
Total other securities		15,325	4.09
Total investment securities available-for-sale	$	715,380	3.98 %

Deposits

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

(Dollars in thousands)		2008 Amount	2008 Rate		2007 Amount	2007 Rate		2006 Amount	2006 Rate
Noninterest bearing demand deposits	$	377,440	-%	$	351,050	-%	$	352,204	-%
Interest bearing demand deposits		1,137,491	1.82		988,308	3.10		715,242	2.51
Savings deposits		285,538	0.63		250,927	1.21		190,347	0.44
Other time deposits		1,573,801	4.09		1,679,521	4.85		1,512,755	4.38
Total deposits	$	3,374,270	-	$	3,269,806	-	$	2,770,548	-

-22-

table of contents

The amount of certificates of deposit of $100,000 or more and other time deposits of $100,000 or more outstanding at December 31, 2008, by time remaining until maturity is as follows:

(Dollars in thousands)	
Under 3 months	$ 124,795
4 – 6 months	97,227
7 – 12 months	102,874
Over 12 months	289,889
Total	$ 614,785

Scheduled maturities of time deposits, including both private and public funds, at December 31, 2008 were as follows:

(Dollars in thousands)	
2009	$ 877,734
2010	471,670
2011	187,918
2012	57,126
2013	22,339
Thereafter	48,367
Total	$ 1,665,154

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
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%
2006								
Balance at December 31, 2006	$	195,262	$	10,907	$	16,549	$	222,718
Maximum amount outstanding at any month-end		265,362		12,922		90,689		368,973
Average amount outstanding		211,973		7,997		45,854		265,824
Weighted average interest rate during the year		3.95%		4.99%		4.87%		4.14%
Weighted average interest rate for outstanding amounts at December 31, 2006		3.41%		5.08%		4.89%		3.60%

table of contents

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 2008, average core deposits equaled 66.31% of average total assets, compared to 67.12% in 2007 and 63.27% in 2006. The effective cost rate of core deposits in 2008 was 2.36%, compared to 3.25% in 2007 and 2.65% in 2006.

Average demand deposits (noninterest bearing core deposits) increased 7.52% in 2008 compared to a decrease of 0.33% in 2007. These represented 12.93% of total core deposits in 2008, compared to 12.60% in 2007, and 15.67% in 2006.

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, Federal funds, 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 2008, our reliance on purchased funds increased to 19.16% of average total assets from 18.19% in 2007.

Shareholders’ Equity — Average shareholders’ equity equated to 10.09% of average total assets in 2008 compared to 9.85% in 2007. Shareholders’ equity was 10.16% of total assets at year-end 2008, compared to 9.68% at year-end 2007. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," we include unrealized gain (loss) on available-for-sale securities, net of income taxes, as accumulated other comprehensive income (loss) which is a component of shareholders’ equity. While regulatory capital adequacy ratios exclude unrealized gain (loss), it does impact our equity as reported in the audited financial statements. The unrealized gain (loss) on available-for-sale securities, net of income taxes, was $5.82 million and $2.52 million at December 31, 2008 and 2007, respectively. Our sale of preferred shares under the TARP Capital Purchase Program subsequent to year-end 2008 increased our shareholders' equity by approximately $111.00 million.

Liquidity Risk Management — The Bank's liquidity is monitored and closely managed by the Asset/Liability Management Committees (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 ensure that adequate liquid funds are available to meet financial commitments on a timely basis. Financial institutions must maintain liquidity to meet day-to-day requirements of depositors and borrowers, take advantage of market opportunities and provide a cushion against unforeseen needs.

Liquidity of the Bank is derived primarily from core deposits, principal payments received on loans, the sale and maturity of investment securities, net cash provided by operating activities, and access to other funding sources. The most stable source of liability funded liquidity is deposit growth and retention of the core deposit base. The principal source of asset-funded liquidity is available-for-sale investment securities, cash and due from banks, Federal funds sold, 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, 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. At December 31, 2007, the aggregate hypothetical decrease in pre-tax earnings was estimated to be $0.44 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 increase in pre-tax earnings was estimated to be $1.37 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 changees in interest ratese. 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, 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 P 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, 2008, 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 obligations payments by period.

(Dollars in thousands)	Note	0 – 1 Year	1 – 3 Years	3 – 5 Years	Over 5 Years	Indeterminate maturity	Total
Deposits without stated maturity	-	$ 1,849,388	$ -	$ -	$ -	$ -	$ 1,849,388
Certificates of deposit	-	877,734	659,588	79,465	48,367	-	1,665,154
Long-term debt	K	10,342	10,682	70	833	7,905	29,832
Subordinated notes	M	-	-	-	89,692	-	89,692
Operating leases	P	2,634	4,153	1,279	734	-	8,800
Purchase obligations	-	19,371	6,164	4,626	-	-	30,161

Total contractual obligations	$ 2,759,469	$ 680,587	$ 85,440	$ 139,626	$ 7,905	$ 3,673,027

table of contents

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, 2008. 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 2008. Subsequent to year-end 2008, we incurred new long-term obligations under our preferred shares issued under the TARP Capital Purchase Program.

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, 2008 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, 2008, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, $5.46 million of unrecognized tax benefits have been excluded from the contractual obligations table above. See Note O 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 P of the Notes to Consolidated Financial Statements.

Quarterly Results of Operations

Three Months Ended (Dollars in thousands, except per share amounts)	March 31	June 30	September 30	December 31
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
Diluted net income per common share	0.38	0.30	0.18	0.50
2007				
Interest income	$ 55,953	$ 62,332	$ 68,330	$ 66,972
Interest expense	29,681	33,461	36,632	34,903
Net interest income	26,272	28,871	31,698	32,069

(Recovery of) provision for loan and lease losses	(623)	1,247	3,660	3,250
Investment securities and other investment gains (losses)	247	207	(154)	(3,428)
Income before income taxes	12,581	12,248	8,495	8,359
Net income	8,523	8,060	6,130	7,826
Diluted net income per common share	0.37	0.34	0.25	0.32

Net income was $12.32 million for the fourth quarter of 2008, compared to the $7.83 million of net income reported for the fourth quarter of 2007. Diluted net income per common share for the fourth quarter of 2008 amounted to $0.50, compared to $0.32 per common share reported in the fourth quarter of 2007.

The net interest margin was 3.30% for the fourth quarter of 2008 versus 3.21% for the same period in 2007. Tax-equivalent net interest income was $34.24 million for the fourth quarter of 2008, up 3.33 percent from 2007's fourth quarter.

Our provision for loan and lease losses was $7.05 million in the fourth quarter of 2008 compared to provision for loan and lease losses of $3.25 million in the fourth quarter of 2007. Net charge-offs were $2.88 million for the fourth quarter 2008, compared to net charge-offs of $1.48 million a year ago.

Noninterest income for the fourth quarter of 2008 was $30.23 million, compared to $16.17 million for the fourth quarter of 2007. The predominate factors causing the increase was the sale of certain assets of Investment Advisors for a gain of $11.49 million, the recording of $0.56 million of impairment on Fannie Mae, Freddie Mac, and other preferred equities versus $4.11 million of impairment on these preferred equities in the fourth quarter of 2007. These increases were partially offset by a decrease in mortgage banking income due to mortgage servicing rights impairment of $1.97 million.

Noninterest expense for the fourth quarter of 2008 was $38.50 million, an increase of 5.12% as compared to the fourth quarter of 2007.

table of contents

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.

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, 2008, 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, 2008, 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 and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008 and our report dated February 20, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 20, 2009

table of contents

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, 2008 and 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. 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, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, 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, 2008, 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 20, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
February 20, 2009

table of contents

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

December 31 (Dollars in thousands)	2008	2007
ASSETS		
Cash and due from banks	$ 119,771	$ 153,137
Federal funds sold and interest bearing deposits with other banks	6,951	25,817
Investment securities available-for-sale (amortized cost of $715,380 and $775,922 at December 31, 2008 and December 31, 2007, respectively)	724,754	779,981
Other investments	18,612	14,937
Trading account securities	100	-
Mortgages held for sale	46,686	25,921
Loans and leases, net of unearned discount:		
Commercial and agricultural loans	643,440	593,806
Auto, light truck and environmental equipment	353,838	305,238
Medium and heavy duty truck	243,375	300,469
Aircraft financing	632,121	587,022
Construction equipment financing	375,983	377,785
Loans secured by real estate	918,749	881,646
Consumer loans	130,706	145,475
Total loans and leases	3,298,212	3,191,441
Reserve for loan and lease losses	(79,776)	(66,602)
Net loans and leases	3,218,436	3,124,839
Equipment owned under operating leases, net	83,062	81,960
Net premises and equipment	40,491	45,048
Goodwill and intangible assets	91,691	93,567
Accrued income and other assets	113,620	101,897
Total assets	$ 4,464,174	$ 4,447,104
LIABILITIES		
Deposits:		
Noninterest bearing	$ 416,960	$ 418,529
Interest bearing	3,097,582	3,051,134
Total deposits	3,514,542	3,469,663
Short-term borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	272,529	303,429
Other short-term borrowings	23,646	34,403
Total short-term borrowings	296,175	337,832
Long-term debt and mandatorily redeemable securities	29,832	34,702
Subordinated notes	89,692	100,002
Accrued expenses and other liabilities	80,269	74,401
Total liabilities	4,010,510	4,016,600
SHAREHOLDERS' EQUITY		
Preferred stock; no par value		
Authorized 10,000,000 shares; none issued or outstanding	-	-
Common stock; no par value		
Authorized 40,000,000 shares; issued 25,895,505 shares in 2008 and 25,927,510 shares in 2007 less unearned shares (251,999 shares in 2008 and 284,004 shares in 2007)	342,982	342,840

Retained earnings		136,877		117,373
Cost of common stock in treasury (1,532,576 shares in 2008 and 1,551,396 shares in 2007)		(32,019)		(32,231)
Accumulated other comprehensive income		5,824		2,522
Total shareholders' equity		453,664		430,504
Total liabilities and shareholders' equity	$	4,464,174	$	4,447,104

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

table of contents

CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 (Dollars in thousands, except per share data)	2008	2007	2006
Interest income:			
Loans and leases	$ 204,006	$ 216,186	$ 181,363
Investment securities, taxable	22,170	25,136	19,177
Investment securities, tax-exempt	7,707	7,608	5,183
Other	1,425	4,657	3,271
Total interest income	235,308	253,587	208,994
Interest expense:			
Deposits	86,903	115,113	85,067
Short-term borrowings	7,626	10,935	11,011
Subordinated notes	6,714	6,051	4,320
Long-term debt and mandatorily redeemable securities	1,905	2,578	2,163
Total interest expense	103,148	134,677	102,561
Net interest income	132,160	118,910	106,433
Provision for (recovery of provision for) loan and lease losses	16,648	7,534	(2,736)
Net interest income after provision for (recovery of provision for) loan and lease losses	115,512	111,376	109,169
Noninterest income:			
Trust fees	18,599	15,567	13,806
Service charges on deposit accounts	22,035	20,470	19,040
Mortgage banking income	2,994	2,868	11,637
Insurance commissions	5,363	4,666	4,574
Equipment rental income	24,224	21,312	18,972
Other income	9,293	8,864	6,554
Gain on sale of certain Investment Advisor assets	11,492	-	-
Investment securities and other investment (losses) gains	(9,997)	(3,128)	2,002
Total noninterest income	84,003	70,619	76,585
Noninterest expense:			
Salaries and employee benefits	76,965	73,944	66,605
Net occupancy expense	9,698	9,030	7,492
Furniture and equipment expense	15,095	15,145	12,316
Depreciation - leased equipment	19,450	17,085	14,958
Professional fees	8,446	4,575	3,998
Supplies and communications	6,782	5,987	5,496
Business development and marketing expense	3,749	4,788	4,008
Loan and lease collection and repossession expense	1,162	1,123	704
Other expense	11,767	8,635	10,634
Total noninterest expense	153,114	140,312	126,211
Income before income taxes	46,401	41,683	59,543
Income taxes	13,015	11,144	20,246
Net income	$ 33,386	$ 30,539	$ 39,297
Basic net income per common share	$ 1.38	$ 1.30	$ 1.74
Diluted net income per common share	$ 1.37	$ 1.28	$ 1.72

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

table of contents

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY