

1ST SOURCE CORP
Form 10-Q
April 21, 2011

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 0-6233

(Exact name of registrant as specified in its charter)

INDIANA
(State or other jurisdiction of
incorporation or organization)

35-1068133
(I.R.S. Employer Identification
No.)

100 North Michigan Street South Bend, IN
(Address of principle executive offices) (Zip Code)

46614

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

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|-----------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="radio"/> | Accelerated filer | <input checked="" type="checkbox"/> |
| Non-accelerated filer (Do not check if a smaller reporting company) | <input type="radio"/> | Smaller reporting company | <input type="radio"/> |

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

Number of shares of common stock outstanding as of April 15, 2011 – 24,303,656 shares

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CERTIFICATIONS

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

| | March 31, 2011 | December 31, 2010 |
|--|-------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$ 57,271 | \$ 62,313 |
| Federal funds sold and interest bearing deposits with other banks | 81,661 | 34,559 |
| Investment securities available-for-sale (amortized cost of \$927,522 and \$952,101 at March 31, 2011 and December 31, 2010, respectively) | 942,221 | 969,018 |
| Other investments | 20,503 | 21,343 |
| Trading account securities | 146 | 138 |
| Mortgages held for sale | 5,467 | 32,599 |
| Loans and leases - net of unearned discount | | |
| Commercial and agricultural loans | 547,381 | 530,228 |
| Auto, light truck and environmental equipment | 416,957 | 396,500 |
| Medium and heavy duty truck | 156,022 | 162,824 |
| Aircraft financing | 601,480 | 614,357 |
| Construction equipment financing | 271,490 | 285,634 |
| Commercial real estate | 578,648 | 594,729 |
| Residential real estate | 386,290 | 390,951 |
| Consumer loans | 93,450 | 95,400 |
| Total loans and leases | 3,051,718 | 3,070,623 |
| Reserve for loan and lease losses | (86,160) | (86,874) |
| Net loans and leases | 2,965,558 | 2,983,749 |
| Equipment owned under operating leases, net | 81,304 | 78,138 |
| Net premises and equipment | 36,024 | 33,881 |
| Goodwill and intangible assets | 88,650 | 88,955 |
| Accrued income and other assets | 133,571 | 140,588 |
| Total assets | 4,412,376 | 4,445,281 |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest bearing | \$ 513,315 | \$ 524,564 |
| Interest bearing | 3,095,692 | 3,098,181 |
| Total deposits | 3,609,007 | 3,622,745 |
| Short-term borrowings: | | |
| Federal funds purchased and securities sold under agreements to repurchase | 112,914 | 136,028 |
| Other short-term borrowings | 19,239 | 19,961 |
| Total short-term borrowings | 132,153 | 155,989 |
| Long-term debt and mandatorily redeemable securities | 26,717 | 24,816 |
| Subordinated notes | 89,692 | 89,692 |
| Accrued expenses and other liabilities | 64,340 | 65,656 |
| Total liabilities | 3,921,909 | 3,958,898 |

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 25,643,506 at March 31, 2011 and December 31, 2010 | 346,535 | 350,282 |
| Retained earnings | 164,455 | 157,875 |
| Cost of common stock in treasury (1,339,860 shares at March 31, 2011 and 1,470,696 shares at December 31, 2010) | (29,655) | (32,284) |
| Accumulated other comprehensive income | 9,132 | 10,510 |
| Total shareholders' equity | 490,467 | 486,383 |
| Total liabilities and shareholders' equity | \$ 4,412,376 | \$ 4,445,281 |

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

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

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2011 | 2010 |
| Interest income: | | |
| Loans and leases | \$ 41,299 | \$ 42,270 |
| Investment securities, taxable | 4,482 | 5,401 |
| Investment securities, tax-exempt | 1,186 | 1,467 |
| Other | 243 | 274 |
| Total interest income | 47,210 | 49,412 |
| Interest expense: | | |
| Deposits | 8,355 | 12,405 |
| Short-term borrowings | 89 | 188 |
| Subordinated notes | 1,647 | 1,647 |
| Long-term debt and mandatorily redeemable securities | 259 | 270 |
| Total interest expense | 10,350 | 14,510 |
| Net interest income | 36,860 | 34,902 |
| Provision for loan and lease losses | 2,198 | 4,388 |
| Net interest income after provision for loan and lease losses | 34,662 | 30,514 |
| Noninterest income: | | |
| Trust fees | 3,992 | 3,745 |
| Service charges on deposit accounts | 4,236 | 4,620 |
| Mortgage banking income | 444 | 777 |
| Insurance commissions | 1,142 | 1,465 |
| Equipment rental income | 6,038 | 6,745 |
| Other income | 2,971 | 2,689 |
| Investment securities and other investment gains | 130 | 881 |
| Total noninterest income | 18,953 | 20,922 |
| Noninterest expense: | | |
| Salaries and employee benefits | 18,638 | 18,810 |
| Net occupancy expense | 2,320 | 2,487 |
| Furniture and equipment expense | 3,349 | 2,800 |
| Depreciation - leased equipment | 4,805 | 5,364 |
| Professional fees | 1,096 | 1,514 |
| Supplies and communication | 1,394 | 1,369 |
| FDIC and other insurance | 1,676 | 1,674 |
| Business development and marketing expense | 622 | 567 |
| Loan and lease collection and repossession expense | 1,324 | 1,106 |
| Other expense | 3,252 | 1,419 |
| Total noninterest expense | 38,476 | 37,110 |

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| | | |
|--|------------|------------|
| Income before income taxes | 15,139 | 14,326 |
| Income tax expense | 4,531 | 4,647 |
| Net income | 10,608 | 9,679 |
| Preferred stock dividends and discount accretion | - | (1,711) |
| Net income available to common shareholders | \$ 10,608 | \$ 7,968 |
| Per common share | | |
| Basic net income per common share | \$ 0.43 | \$ 0.33 |
| Diluted net income per common share | \$ 0.43 | \$ 0.33 |
| Dividends | \$ 0.16 | \$ 0.15 |
| Basic weighted average common shares outstanding | 24,271,366 | 24,210,242 |
| Diluted weighted average common shares outstanding | 24,279,517 | 24,215,506 |

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

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1st SOURCE
CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS'
EQUITY

(Unaudited - Dollars in thousands, except
per share amounts)

| | Total | Preferred Stock | Common Stock | Retained Earnings | Cost of Common Stock in Treasury | Accumulated Other Comprehensive Income (Loss), Net |
|---|------------|--------------------|-----------------|----------------------|--|--|
| Balance at January 1, 2010 | \$ 570,320 | \$ 104,930 | \$ 350,269 | \$ 142,407 | \$ (32,380) | \$ 5,094 |
| Comprehensive Income, net of tax: | | | | | | |
| Net Income | 9,679 | - | - | 9,679 | - | - |
| Change in unrealized appreciation of available-for-sale securities, net of tax | 1,578 | - | - | - | - | 1,578 |
| Reclassification adjustment for gains included in net income, net of tax | (174) | - | - | - | - | (174) |
| Total Comprehensive Income | 11,083 | - | - | - | - | - |
| Issuance of 182,934 common shares under stock based compensation awards, including related tax effects | 2,778 | - | - | 632 | 2,146 | - |
| Cost of 7,269 shares of common stock acquired for treasury | (114) | - | - | - | (114) | - |
| Preferred stock discount accretion | - | 324 | - | (324) | - | - |
| Preferred stock dividend (paid and/or accrued) | (1,387) | - | - | (1,387) | - | - |
| Common stock dividend (\$0.15 per share) | (3,626) | - | - | (3,626) | - | - |
| Stock based compensation | 3 | - | 3 | - | - | - |
| Balance at March 31, 2010 | \$ 579,057 | \$ 105,254 | \$ 350,272 | \$ 147,381 | \$ (30,348) | \$ 6,498 |

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| | | | | | | |
|--|------------|------|------------|------------|--------------|-----------|
| Balance at January 1, 2011 | \$ 486,383 | \$ - | \$ 350,282 | \$ 157,875 | \$ (32,284) | \$ 10,510 |
| Comprehensive Income, net of tax: | | | | | | |
| Net Income | 10,608 | - | - | 10,608 | - | - |
| Change in unrealized appreciation of available-for-sale securities, net of tax | (1,250) | - | - | - | - | (1,250) |
| Reclassification adjustment for gains included in net income, net of tax | (128) | - | - | - | - | (128) |
| Total Comprehensive Income | 9,230 | - | - | - | - | - |
| Issuance of 139,736 common shares under stock based compensation awards, including related tax effects | 2,666 | - | - | (126) | 2,792 | - |
| Cost of 8,900 shares of common stock acquired for treasury | (163) | - | - | - | (163) | - |
| Repurchase of common stock warrant | (3,750) | - | (3,750) | - | - | - |
| Common stock dividend (\$0.16 per share) | (3,902) | - | - | (3,902) | - | - |
| Stock based compensation | 3 | - | 3 | - | - | - |
| Balance at March 31, 2011 | \$ 490,467 | \$ - | \$ 346,535 | \$ 164,455 | \$ (29,655) | \$ 9,132 |

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

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

| | Three Months Ended March 31, | |
|--|------------------------------|------------|
| | 2011 | 2010 |
| Operating activities: | | |
| Net income | \$ 10,608 | \$ 9,679 |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Provision for loan and lease losses | 2,198 | 4,388 |
| Depreciation of premises and equipment | 873 | 1,182 |
| Depreciation of equipment owned and leased to others | 4,805 | 5,364 |
| Amortization of investment security premiums and accretion of discounts, net | 485 | 668 |
| Amortization of mortgage servicing rights | 734 | 761 |
| Mortgage servicing asset impairment (recovery) | 5 | (1) |
| Deferred income taxes | (297) | 948 |
| Investment securities and other investment gains | (130) | (881) |
| Originations/purchases of loans held for sale, net of principal collected | (25,343) | (50,208) |
| Proceeds from the sales of loans held for sale | 52,560 | 54,303 |
| Net gain on sale of loans held for sale | (85) | (512) |
| Change in trading account securities | (8) | (5) |
| Change in interest receivable | (116) | 75 |
| Change in interest payable | 1,905 | 1,110 |
| Change in other assets | 6,701 | (1,337) |
| Change in other liabilities | (2,083) | 8,573 |
| Other | 1,696 | 15 |
| Net change in operating activities | 54,508 | 34,122 |
| Investing activities: | | |
| Proceeds from sales of investment securities | 66,989 | 71,579 |
| Proceeds from maturities of investment securities | 67,756 | 123,734 |
| Purchases of investment securities | (110,522) | (180,063) |
| Net change in other investments | 840 | 1,403 |
| Loans sold or participated to others | 4,010 | 4,586 |
| Net change in loans and leases | 11,983 | (22,348) |
| Net change in equipment owned under operating leases | (7,971) | (586) |
| Purchases of premises and equipment | (3,047) | (857) |
| Net change in investing activities | 30,038 | (2,552) |
| Financing activities: | | |
| Net change in demand deposits, NOW accounts and savings accounts | (33,730) | (69,419) |
| Net change in certificates of deposit | 19,992 | (43,915) |
| Net change in short-term borrowings | (23,836) | (8,964) |
| Proceeds from issuance of long-term debt | 417 | 5,303 |
| Payments on long-term debt | (114) | (139) |
| Net proceeds from issuance of treasury stock | 2,666 | 2,778 |

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| | | |
|---|------------|------------|
| Acquisition of treasury stock | (163) | (114) |
| Repurchase of common stock warrant | (3,750) | - |
| Cash dividends paid on preferred stock | - | (1,387) |
| Cash dividends paid on common stock | (3,968) | (3,690) |
| Net change in financing activities | (42,486) | (119,547) |
| Net change in cash and cash equivalents | 42,060 | (87,977) |
| Cash and cash equivalents, beginning of year | 96,872 | 210,102 |
| Cash and cash equivalents, end of period | \$ 138,932 | \$ 122,125 |
| Non-cash transactions: | | |
| Loans transferred to other real estate and repossessed assets | \$ 3,931 | \$ 4,242 |
| Common stock matching contribution to KSOP plan | 2,420 | 2,545 |

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

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1ST SOURCE CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements reflect all adjustments (all of which are normal and recurring in nature) which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, the results of operations, changes in shareholders' equity, and cash flows for the periods presented. These unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been omitted. The Notes to the Consolidated Financial Statements appearing in 1st Source Corporation's Annual Report on Form 10-K (2010 Annual Report), which include descriptions of significant accounting policies, should be read in conjunction with these interim financial statements. The balance sheet at December 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Certain amounts in the prior period consolidated financial statements have been reclassified to conform with the current year presentation.

Cash Flow – For purposes of the consolidated statements of cash flow, we consider cash and due from banks, federal funds sold and interest bearing deposits with other banks with original maturities of three months or less as cash and cash equivalents.

Note 2. Recent Accounting Pronouncements

Receivables: In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-02 "Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring." ASU 2011-02 clarifies whether loan modifications constitute troubled debt restructuring. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 is effective for the first interim and annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. We are assessing the impact of ASU 2011-02 on our financial condition, results of operations, and disclosures.

Business Combinations: In December 2010, the FASB issued ASU No. 2010-29 "Business Combinations (Topic 805) - Disclosure of Supplementary Pro Forma Information for Business Combinations." If a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU 2010-29 also expands the supplementary pro forma disclosures. ASU 2010-29 was effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. ASU 2010-29 will only affect us if there are future business combinations.

Intangibles - Goodwill and Other: In December 2010, the FASB issued ASU No. 2010-28 "Intangibles - Goodwill and Other (Topic 350) - When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts." ASU 2010-28 affects all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or

negative. ASU 2010-28 was effective for fiscal years and interim periods within those years, beginning after December 15, 2010. ASU 2010-28 did not have an impact on our financial condition, results of operations, or disclosures.

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Note 3. Investment Securities

Investment securities available-for-sale were as follows:

| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|-------------------|------------------------------|-------------------------------|------------|
| March 31, 2011 | | | | |
| U.S. Treasury and Federal agencies securities | \$434,510 | \$4,461 | \$(1,328) | \$437,643 |
| U.S. States and political subdivisions securities | 120,814 | 4,153 | (1,103) | 123,864 |
| Mortgage-backed securities – Federal agencies | 327,458 | 6,741 | (441) | 333,758 |
| Corporate debt securities | 35,677 | 167 | (249) | 35,595 |
| Foreign government and other securities | 6,717 | 23 | (51) | 6,689 |
| Total debt securities | 925,176 | 15,545 | (3,172) | 937,549 |
| Marketable equity securities | 2,346 | 2,329 | (3) | 4,672 |
| Total investment securities available-for-sale | \$927,522 | \$17,874 | \$(3,175) | \$942,221 |
| December 31, 2010 | | | | |
| U.S. Treasury and Federal agencies securities | \$442,612 | \$5,546 | \$(849) | \$447,309 |
| U.S. States and political subdivisions securities | 147,679 | 4,381 | (1,753) | 150,307 |
| Mortgage-backed securities – Federal agencies | 309,046 | 7,854 | (232) | 316,668 |
| Corporate debt securities | 45,778 | 182 | (345) | 45,615 |
| Foreign government and other securities | 5,732 | 18 | (34) | 5,716 |
| Total debt securities | 950,847 | 17,981 | (3,213) | 965,615 |
| Marketable equity securities | 1,254 | 2,152 | (3) | 3,403 |
| Total investment securities available-for-sale | \$952,101 | \$20,133 | \$(3,216) | \$969,018 |

At March 31, 2011, the residential mortgage-backed securities we held consisted primarily of GNMA, FNMA and FHLMC pass-through certificates which are guaranteed by those respective agencies of the United States government (or Government Sponsored Enterprise, GSEs).

The contractual maturities of debt securities available-for-sale at March 31, 2011 are shown below. Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)

| | Amortized Cost | Fair Value |
|--|-------------------|------------|
| Due in one year or less | \$ 40,341 | \$ 40,737 |
| Due after one year through five years | 437,823 | 442,361 |
| Due after five years through ten years | 108,324 | 110,481 |
| Due after ten years | 11,230 | 10,212 |
| Mortgage-backed securities | 327,458 | 333,758 |
| Total debt securities available-for-sale | \$ 925,176 | \$ 937,549 |

The following table shows the gross realized gains and losses on sale of securities from the securities available-for-sale portfolio, including marketable equity securities. Realized gains and losses on the sales of all securities are computed using the specific identification cost basis. The gross gains and losses in the first three

months of 2011 primarily reflect the sale of municipal, FHLB and FFCB debt securities. The sale of municipal securities was to reduce credit risk exposure in certain states. The action to sell agency securities was to improve future yield. There was no impact to other than temporary impairment (OTTI) as a result of the first quarter 2011 sales. The gross gains and losses in the first three months of 2010 reflect the disposition of FNMA and FHLMC debt securities. There were no OTTI write-downs in 2011.

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(Dollars in thousands)

| | Three Months Ended March 31, | |
|-----------------------------|---------------------------------|--------|
| | 2011 | 2010 |
| Gross realized gains | \$ 445 | \$ 292 |
| Gross realized losses | (238) | (12) |
| Net realized gains (losses) | \$ 207 | \$ 280 |

There were net gains of \$8 thousand for the three months ended March 31, 2011 and net gains of \$5 thousand recorded for the three months ended March 31, 2010 on \$0.15 million in trading securities outstanding at March 31, 2011 and \$0.14 million at December 31, 2010.

The following tables summarize our gross unrealized losses and fair value by investment category and age:

| (Dollars in thousands) | Less than 12 Months | | 12 months or Longer | | Total | |
|---|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| March 31, 2011 | | | | | | |
| U.S. Treasury and Federal agencies securities | \$ 156,626 | \$ (1,328) | \$ - | \$ - | \$ 156,626 | \$ (1,328) |
| U.S. States and political subdivisions securities | 7,447 | (132) | 9,591 | (971) | 17,038 | (1,103) |
| Mortgage-backed securities - Federal agencies | 36,872 | (408) | 4,450 | (33) | 41,322 | (441) |
| Corporate debt securities | 26,398 | (249) | - | - | 26,398 | (249) |
| Foreign government and other securities | 2,962 | (51) | - | - | 2,962 | (51) |
| Total debt securities | 230,305 | (2,168) | 14,041 | (1,004) | 244,346 | (3,172) |
| Marketable equity securities | - | - | 5 | (3) | 5 | (3) |
| Total investment securities available-for-sale | \$ 230,305 | \$ (2,168) | \$ 14,046 | \$ (1,007) | \$ 244,351 | \$ (3,175) |
| December 31, 2010 | | | | | | |
| U.S. Treasury and Federal agencies securities | \$ 158,497 | \$ (849) | \$ - | \$ - | \$ 158,497 | \$ (849) |
| U.S. States and political subdivisions securities | 9,226 | (246) | 9,055 | (1,507) | 18,281 | (1,753) |
| Mortgage-backed securities - Federal agencies | 23,351 | (213) | 4,887 | (19) | 28,238 | (232) |
| Corporate debt securities | 26,407 | (345) | - | - | 26,407 | (345) |
| Foreign government and other securities | 3,015 | (34) | - | - | 3,015 | (34) |
| Total debt securities | 220,496 | (1,687) | 13,942 | (1,526) | 234,438 | (3,213) |
| Marketable equity securities | - | - | 5 | (3) | 5 | (3) |
| Total investment securities available-for-sale | \$ 220,496 | \$ (1,687) | \$ 13,947 | \$ (1,529) | \$ 234,443 | \$ (3,216) |

The initial indication of OTTI for both debt and equity securities is a decline in fair value below amortized cost. Quarterly, the impaired securities are analyzed on a qualitative and quantitative basis in determining

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

At March 31, 2011, we do not have the intent to sell any of the available-for-sale securities in the table above and believe that it is more likely than not that we will not have to sell any such securities before an anticipated recovery of cost. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased and market illiquidity on auction rate securities which are reflected in U.S. States and Political subdivisions securities. The fair value is expected to recover on all debt securities as they approach their maturity date or repricing date or if market yields for such investments decline.

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We do not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of March 31, 2011, we believe the impairments detailed in the table above are temporary and no impairment loss has been realized in our consolidated statements of income.

At March 31, 2011 and December 31, 2010, investment securities with carrying values of \$256.64 million and \$299.88 million, respectively, were pledged as collateral to secure government deposits, security repurchase agreements, and for other purposes.

Note 4. Loan and Lease Financings

We evaluate loans and leases for credit quality on a monthly basis. All loans and leases, except residential real estate loans and consumer loans, are assigned credit quality ratings on a scale from 1 to 12 with grade 1 representing superior credit quality. The criteria used to assign quality ratings to extensions of credit that exhibit potential problems or well-defined weaknesses are primarily based upon the degree of risk and the likelihood of orderly repayment, and their effect on the Bank's safety and soundness. Loans graded 7 or weaker are considered "special attention" credits and, as such, relationships in excess of \$100,000 are reviewed quarterly as part of management's evaluation of the adequacy of the reserve for loan and lease losses. Grade 7 credits are defined as "watch" and contain greater than average credit risk and thus warrant timely follow-up to limit the Bank's exposure to increased risk; grade 8 credits are "special mention" and, following regulatory guidelines, are defined as having potential weaknesses that deserve management's close attention. Credits that exhibit well-defined weaknesses and a distinct possibility of loss are considered "classified" and are graded 9 through 12 corresponding to the regulatory definitions of "substandard" (grades 9 and 10) and the more severe "doubtful" (grade 11) and "loss" (grade 12).

The table below presents the credit quality category of the recorded investment in loans and leases, segregated by class.

| (Dollars in thousands) | Grade: | | |
|---|---------------------|-------------------|---------------------|
| | 1-6 | 7-12 | Total |
| March 31, 2011 | | | |
| Commercial and agricultural loans | \$ 504,137 | \$ 43,244 | \$ 547,381 |
| Auto, light truck, and environmental equipment | 412,155 | 4,802 | 416,957 |
| Medium and heavy duty truck | 135,750 | 20,272 | 156,022 |
| Aircraft financing | 546,740 | 54,740 | 601,480 |
| Construction equipment financing | 240,214 | 31,276 | 271,490 |
| Commercial real estate | 518,801 | 59,847 | 578,648 |
| Total | \$ 2,357,797 | \$ 214,181 | \$ 2,571,978 |
| December 31, 2010 | | | |
| Commercial and agricultural loans | \$ 483,603 | \$ 46,625 | \$ 530,228 |
| Auto, light truck, and environmental equipment | 389,774 | 6,726 | 396,500 |
| Medium and heavy duty truck | 143,431 | 19,393 | 162,824 |
| Aircraft financing | 555,106 | 59,251 | 614,357 |
| Construction equipment financing | 246,644 | 38,990 | 285,634 |
| Commercial real estate | 532,581 | 62,148 | 594,729 |
| Total | \$ 2,351,139 | \$ 233,133 | \$ 2,584,272 |

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The table below presents the recorded investment in residential real estate and consumer loans by performing or non-performing status. Non-performing loans are those loans which are on nonaccrual status or are 90 days or more past due.

(Dollars in thousands)

| | Performing | Nonperforming | Total |
|-------------------------|------------|---------------|------------|
| March 31, 2011 | | | |
| Residential real estate | \$ 380,796 | \$ 5,494 | \$ 386,290 |
| Consumer | 92,882 | 568 | 93,450 |
| Total | \$ 473,678 | \$ 6,062 | \$ 479,740 |
| December 31, 2010 | | | |
| Residential real estate | \$ 385,729 | \$ 5,222 | \$ 390,951 |
| Consumer | 94,973 | 427 | 95,400 |
| Total | \$ 480,702 | \$ 5,649 | \$ 486,351 |

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

| (Dollars in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Nonaccrual | Current | Total | Recorded Investment > 90 Days and Accruing |
|---|---------------------------|---------------------------|-----------------------------------|----------------------|------------|--------------|--------------------------|---|
| | | | | | | | Financing Receivables | |
| March 31, 2011 | | | | | | | | |
| Commercial and agricultural loans | \$ 498 | \$ 202 | \$ - | \$ 700 | \$ 7,987 | \$ 538,694 | \$ 547,381 | \$ - |
| Auto, light truck and environmental equipment | 726 | 216 | - | 942 | 2,825 | 413,190 | 416,957 | - |
| Medium and heavy duty truck | 51 | - | - | 51 | 4,662 | 151,309 | 156,022 | - |
| Aircraft financing | 5,297 | 713 | - | 6,010 | 15,945 | 579,525 | 601,480 | - |
| Construction equipment financing | 3,463 | 29 | - | 3,492 | 8,077 | 259,921 | 271,490 | - |
| Commercial real estate | 328 | 943 | - | 1,271 | 28,995 | 548,382 | 578,648 | - |
| Residential real estate | 2,477 | 595 | 434 | 3,506 | 5,060 | 377,724 | 386,290 | 434 |
| Consumer | 859 | 341 | 81 | 1,281 | 487 | 91,682 | 93,450 | 81 |
| Total | \$ 13,699 | \$ 3,039 | \$ 515 | \$ 17,253 | \$ 74,038 | \$ 2,960,427 | \$ 3,051,718 | \$ 515 |
| December 31, 2010 | | | | | | | | |
| Commercial and agricultural loans | \$ 760 | \$ 22 | \$ - | \$ 782 | \$ 8,083 | \$ 521,363 | \$ 530,228 | \$ - |
| Auto, light truck and environmental equipment | 528 | 715 | - | 1,243 | 3,332 | 391,925 | 396,500 | - |
| | 33 | - | - | 33 | 5,068 | 157,723 | 162,824 | - |

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Medium and heavy
duty truck

| | | | | | | | | |
|-------------------------------------|-----------|----------|--------|-----------|-----------|--------------|--------------|--------|
| Aircraft financing | 16,097 | 188 | - | 16,285 | 17,898 | 580,174 | 614,357 | - |
| Construction equipment financing | 1,254 | 601 | - | 1,855 | 8,575 | 275,204 | 285,634 | - |
| Commercial real estate | 759 | 94 | - | 853 | 26,622 | 567,254 | 594,729 | - |
| Residential real estate | 3,781 | 580 | 264 | 4,625 | 4,958 | 381,368 | 390,951 | 264 |
| Consumer | 1,152 | 531 | 98 | 1,781 | 329 | 93,290 | 95,400 | 98 |
| Total | \$ 24,364 | \$ 2,731 | \$ 362 | \$ 27,457 | \$ 74,865 | \$ 2,968,301 | \$ 3,070,623 | \$ 362 |

As of March 31, 2011 and December 31, 2010, we had \$7.36 million and \$7.31 million, respectively of performing loans classified as troubled debt restructuring.

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Note 5. Reserve for Loan and Lease Losses

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

The reserve for loan and lease losses is maintained at a level believed to be adequate by management to absorb probable losses inherent in the loan and lease portfolio. The determination of the reserve requires significant judgment reflecting management's best estimate of probable loan and lease losses related to specifically identified loans and leases as well as probable losses in the remainder of the various loan and lease portfolios. For purposes of determining the reserve, we have segmented our loans and leases into classes based on the associated risks within these segments. We have determined that eight classes exist within our loan and lease portfolio. The methodology for assessing the appropriateness of the reserve consists of several key elements, which include: specific reserves for impaired loans, percentage allocations for special attention loans and leases (classified loans and leases and internal watch list credits) without specific reserves, formula reserves for each business lending division portfolio, and reserves for pooled homogeneous loans and leases. Management's evaluation is based upon a continuing review of these portfolios, estimates of customer performance, collateral values and dispositions, and assessments of economic and geopolitical events, all of which are subject to judgment and will change.

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Changes in the reserve for loan and lease losses, segregated by class, for the three months ended March 31, 2011 and 2010 are shown below.

| (Dollars in thousands) | Commercial and agricultural loans | Auto, light truck and environmental equipment | Medium and heavy duty truck | Aircraft financing | Construction equipment financing | Commercial real estate | Residential real estate | Consumer loans | Total |
|---|-----------------------------------|---|-----------------------------|--------------------|----------------------------------|------------------------|-------------------------|----------------|--------------|
| March 31, 2011 | | | | | | | | | |
| Reserve for loan and lease losses | | | | | | | | | |
| Balance, beginning of period | \$ 20,544 | \$ 7,542 | \$ 5,768 | \$ 29,811 | \$ 8,439 | \$ 11,177 | \$ 2,518 | \$ 1,075 | \$ 86,874 |
| Charge-offs | 422 | 68 | - | 1,098 | 585 | 1,231 | 34 | 595 | 4,033 |
| Recoveries | 124 | 45 | 1 | 674 | 35 | 105 | 3 | 134 | 1,121 |
| Net charge-offs (recoveries) | 298 | 23 | (1) | 424 | 550 | 1,126 | 31 | 461 | 2,912 |
| Provision (recovery of provision) | (3,941) | 405 | (704) | 1,516 | (1,091) | 5,484 | 55 | 474 | 2,198 |
| Balance, end of period | \$ 16,305 | \$ 7,924 | \$ 5,065 | \$ 30,903 | \$ 6,798 | \$ 15,535 | \$ 2,542 | \$ 1,088 | \$ 86,160 |
| Ending balance: individually evaluated for impairment | \$ 4,025 | \$ 308 | \$ 171 | \$ 2,174 | \$ 47 | \$ 1,348 | \$ - | \$ - | \$ 8,073 |
| Ending balance: collectively evaluated for impairment | \$ 12,280 | \$ 7,616 | \$ 4,894 | \$ 28,729 | \$ 6,751 | \$ 14,187 | \$ 2,542 | \$ 1,088 | \$ 78,087 |
| Financing receivables: | | | | | | | | | |
| Ending balance | \$ 547,381 | \$ 416,957 | \$ 156,022 | \$ 601,480 | \$ 271,490 | \$ 578,648 | \$ 386,290 | \$ 93,450 | \$ 3,051,718 |
| Ending balance: individually evaluated for impairment | \$ 12,769 | \$ 1,993 | \$ 4,692 | \$ 16,462 | \$ 8,065 | \$ 31,489 | \$ - | \$ - | \$ 75,470 |

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Ending
balance:
collectively
evaluated for
impairment \$ 534,612 \$ 414,964 \$ 151,330 \$ 585,018 \$ 263,425 \$ 547,159 \$ 386,290 \$ 93,450 \$ 2,976,248

March 31,
2010

Reserve for
loan and lease
losses

Balance,
beginning of
period \$ 24,017 \$ 9,630 \$ 6,186 \$ 24,807 \$ 8,875 \$ 10,453 \$ 880 \$ 3,388 \$ 88,236

Charge-offs 348 472 601 2,567 509 340 165 377 5,379

Recoveries 245 34 39 72 42 - 1 149 582

Net
charge-offs
(recoveries) 103 438 562 2,495 467 340 164 228 4,797

Provision
(recovery of
provision) (2,798) (28) 1,745 (615) 982 4,649 1,834 (1,381) 4,388

Balance, end
of period \$ 21,116 \$ 9,164 \$ 7,369 \$ 21,697 \$ 9,390 \$ 14,762 \$ 2,550 \$ 1,779 \$ 87,827

Ending
balance:
individually
evaluated for
impairment \$ 1,357 \$ 543 \$ 2,134 \$ 75 \$ 1,731 \$ 4,232 \$ - \$ - \$ 10,072

Ending
balance:
collectively
evaluated for
impairment \$ 19,759 \$ 8,621 \$ 5,235 \$ 21,622 \$ 7,659 \$ 10,530 \$ 2,550 \$ 1,779 \$ 77,755

Financing
receivables:

Ending
balance \$ 546,826 \$ 364,445 \$ 200,228 \$ 608,643 \$ 303,866 \$ 584,756 \$ 392,911 \$ 104,440 \$ 3,106,115

Ending
balance:
individually
evaluated for
impairment \$ 8,274 \$ 3,935 \$ 15,310 \$ 2,786 \$ 11,617 \$ 31,699 \$ - \$ - \$ 73,621

Ending
balance:
collectively
evaluated for
impairment \$ 538,552 \$ 360,510 \$ 184,918 \$ 605,857 \$ 292,249 \$ 553,057 \$ 392,911 \$ 104,440 \$ 3,032,494

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

| (Dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|
| March 31, 2011 | | | | |
| With no related allowance recorded: | | | | |
| Commercial and agricultural loans | \$ 4,737 | \$ 4,737 | \$ - | \$ 5,010 |
| Auto, light truck and environmental equipment | 1,099 | 1,099 | - | 1,378 |
| Medium and heavy duty truck | 1,596 | 1,596 | - | 1,657 |
| Aircraft financing | 5,743 | 5,743 | - | 7,506 |
| Construction equipment financing | 7,251 | 7,250 | - | 7,558 |
| Commercial real estate | 22,437 | 22,437 | - | 22,354 |
| Total with no related allowance recorded | 42,863 | 42,862 | - | 45,463 |
| With an allowance recorded: | | | | |
| Commercial and agricultural loans | 8,032 | 8,031 | 4,025 | 7,960 |
| Auto, light truck and environmental equipment | 894 | 894 | 308 | 859 |
| Medium and heavy duty truck | 3,096 | 3,096 | 171 | 3,153 |
| Aircraft financing | 10,719 | 10,718 | 2,174 | 8,771 |
| Construction equipment financing | 814 | 814 | 47 | 753 |
| Commercial real estate | 9,052 | 9,057 | 1,348 | 7,509 |
| Total with an allowance recorded | 32,607 | 32,610 | 8,073 | 29,005 |
| Total: | | | | |
| Commercial and agricultural loans | 12,769 | 12,768 | 4,025 | 12,970 |
| Auto, light truck and environmental equipment | 1,993 | 1,993 | 308 | 2,237 |
| Medium and heavy duty truck | 4,692 | 4,692 | 171 | 4,810 |
| Aircraft financing | 16,462 | 16,461 | 2,174 | 16,277 |
| Construction equipment financing | 8,065 | 8,064 | 47 | 8,311 |
| Commercial real estate | 31,489 | 31,494 | 1,348 | 29,863 |
| Total impaired loans | \$ 75,470 | \$ 75,472 | \$ 8,073 | \$ 74,468 |
| December 31, 2010 | | | | |
| With no related allowance recorded: | | | | |
| Commercial and agricultural loans | \$ 4,930 | \$ 4,930 | \$ - | \$ 4,848 |
| Auto, light truck and environmental equipment | 1,596 | 1,597 | - | 1,632 |
| Medium and heavy duty truck | 1,748 | 1,748 | - | 2,922 |
| Aircraft financing | 4,509 | 4,509 | - | 3,315 |
| Construction equipment financing | 5,534 | 5,535 | - | 5,107 |
| Commercial real estate | 21,071 | 21,071 | - | 20,301 |
| Total with no related allowance recorded | 39,388 | 39,390 | - | 38,125 |
| With an allowance recorded: | | | | |
| Commercial and agricultural loans | 8,282 | 8,281 | 4,190 | 11,210 |
| | 1,136 | 1,136 | 377 | 1,714 |

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Auto, light truck and environmental equipment

| | | | | |
|----------------------------------|--------|--------|-------|--------|
| Medium and heavy duty truck | 3,347 | 3,347 | 1,049 | 5,591 |
| Aircraft financing | 13,913 | 13,913 | 2,050 | 8,626 |
| Construction equipment financing | 3,374 | 3,379 | 648 | 5,485 |
| Commercial real estate | 8,625 | 8,630 | 893 | 9,489 |
| Total with an allowance recorded | 38,677 | 38,686 | 9,207 | 42,115 |

Total:

| | | | | |
|---|-----------|-----------|----------|-----------|
| Commercial and agricultural loans | 13,212 | 13,211 | 4,190 | 16,058 |
| Auto, light truck and environmental equipment | 2,732 | 2,733 | 377 | 3,346 |
| Medium and heavy duty truck | 5,095 | 5,095 | 1,049 | 8,513 |
| Aircraft financing | 18,422 | 18,422 | 2,050 | 11,941 |
| Construction equipment financing | 8,908 | 8,914 | 648 | 10,592 |
| Commercial real estate | 29,696 | 29,701 | 893 | 29,790 |
| Total impaired loans | \$ 78,065 | \$ 78,076 | \$ 9,207 | \$ 80,240 |

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(Dollars in thousands)

| | Three Months Ended March 31, | |
|---|---------------------------------|--------|
| | 2011 | 2010 |
| Commercial and agricultural loans | \$ 116 | \$ 25 |
| Auto, light truck and environmental equipment | 1 | - |
| Medium and heavy duty truck | 1 | 2 |
| Aircraft financing | 9 | - |
| Construction equipment financing | 9 | 88 |
| Commercial real estate | 65 | 24 |
| Total impaired loans | \$ 201 | \$ 139 |

Note 6. Mortgage Servicing Assets

We recognize the rights to service residential mortgage loans for others as separate assets, whether the servicing rights are acquired through a separate purchase or through the sale of originated loans with servicing rights retained. We allocate a portion of the total proceeds of a mortgage loan to servicing rights based on the fair value.

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

Changes in the carrying value of mortgage servicing assets and the associated valuation allowance follow:

| (Dollars in thousands) | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2011 | 2010 |
| Mortgage servicing assets: | | |
| Balance at beginning of period | \$ 7,556 | \$ 8,749 |
| Additions | 146 | 571 |
| Amortization | (734) | (761) |
| Sales | - | (443) |
| Carrying value before valuation allowance at end of period | 6,968 | 8,116 |
| Valuation allowance: | | |
| Balance at beginning of period | - | (1) |
| Impairment (charges) recoveries | (5) | 1 |
| Balance at end of period | \$ (5) | \$ - |
| Net carrying value of mortgage servicing assets at end of period | \$ 6,963 | \$ 8,116 |
| Fair value of mortgage servicing assets at end of period | \$ 10,194 | \$ 10,575 |

During the three months ended March 31, 2011 and 2010, management determined that it was not necessary to permanently write-down any previously established valuation allowance. At March 31, 2011, the fair value of mortgage servicing assets exceeded the carrying value reported in the consolidated statement of financial condition by \$3.23 million. This difference represents increases in the fair value of certain mortgage servicing assets that could not be recorded above cost basis.

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The key economic assumptions used to estimate the fair value of the mortgage servicing rights follow:

| | March 31, | |
|---|-----------|---------|
| | 2011 | 2010 |
| Expected weighted-average life (in years) | 3.46 | 3.55 |
| Weighted-average constant prepayment rate (CPR) | 18.00 % | 17.64 % |
| Weighted-average discount rate | 9.56 % | 8.48 % |

Mortgage loan contractual servicing fees, including late fees and ancillary income, were \$1.02 million for both the three months ended March 31, 2011 and 2010. Mortgage loan contractual servicing fees are included in mortgage banking income in the consolidated statements of income.

Note 7. Financial Instruments with Off-Balance-Sheet Risk and Derivative Transactions

To meet the financing needs of our customers, 1st Source Corporation and its subsidiaries are parties to financial instruments with off-balance-sheet risk in the normal course of business. These off-balance-sheet financial instruments include commitments to originate, purchase and sell loans and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Our exposure to credit loss in the event of nonperformance by the other party to the financial instruments for loan commitments and standby letters of credit is represented by the dollar amount of those instruments. We use the same credit policies and collateral requirements in making commitments and conditional obligations as we do for on-balance-sheet instruments.

We have certain interest rate derivative positions that are not designated as hedging instruments. These derivative positions relate to transactions in which we enter into an interest rate swap with a client while at the same time entering into an offsetting interest rate swap with another financial institution. In connection with each transaction, we agree to pay interest to the client on a notional amount at a variable interest rate and receive interest from the client on the same notional amount at a fixed interest rate. At the same time, we agree to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows our client to effectively convert a variable rate loan to a fixed rate. Because the terms of the swaps with our customers and the other financial institution offset each other, with the only difference being counterparty credit risk, changes in the fair value of the underlying derivative contracts are not materially different and do not significantly impact our results of operations.

1st Source Bank (Bank), a subsidiary of 1st Source Corporation, grants mortgage loan commitments to borrowers, subject to normal loan underwriting standards. The interest rate risk associated with these loan commitments is managed by entering into contracts for future deliveries of loans. Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments to originate or purchase residential mortgage loans held for sale and forward commitments to sell residential mortgage loans are considered derivative instruments.

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At March 31, 2011 and December 31, 2010, the amounts of non-hedging derivative financial instruments are shown in the chart below:

| (Dollars in thousands) | Notional or contractual amount | Asset derivatives | | Liability derivatives | |
|------------------------------|--------------------------------|---|------------------|---|------------------|
| | | Statement of Financial Condition location | Fair value | Statement of Financial Condition location | Fair value |
| March 31, 2011 | | | | | |
| Interest rate swap contracts | \$ 436,745 | Other assets | \$ 12,391 | Other liabilities | \$ 12,781 |
| Loan commitments | 13,263 | Mortgages held for sale | 71 | N/A | - |
| Forward contracts | 9,500 | N/A | - | Mortgages held for sale | 42 |
| Total | \$ 459,508 | | \$ 12,462 | | \$ 12,823 |
| December 31, 2010 | | | | | |
| Interest rate swap contracts | \$ 446,224 | Other assets | \$ 14,959 | Other liabilities | \$ 15,384 |
| Loan commitments | 28,666 | Mortgages held for sale | 30 | N/A | - |
| Forward contracts | 40,320 | Mortgages held for sale | 451 | N/A | - |
| Total | \$ 515,210 | | \$ 15,440 | | \$ 15,384 |

For the three months ended March 31, 2011 and 2010, the amounts included in the consolidated statements of income for non-hedging derivative financial instruments are shown in the chart below:

| (Dollars in thousands) | Statement of Income location | Gain (loss) Three Months Ended March 31, | |
|------------------------------|------------------------------|--|------------------|
| | | 2011 | 2010 |
| Interest rate swap contracts | Other expense | \$ 2 | \$ (35) |
| Interest rate swap contracts | Other income | 27 | 77 |
| Loan commitments | Mortgage banking income | 41 | 107 |
| Forward contracts | Mortgage banking income | (493) | (325) |
| Total | | \$ (423) | \$ (176) |

We issue letters of credit which are conditional commitments that guarantee the performance of a customer to a third party. The credit risk involved and collateral obtained in issuing letters of credit is essentially the same as that

involved in extending loan commitments to customers. Standby letters of credit totaled \$17.80 million and \$17.84 million at March 31, 2011 and December 31, 2010, respectively. Standby letters of credit generally have terms ranging from six months to one year.

Note 8. Earnings Per Share

Earnings per common share is computed using the two-class method. Basic earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include non-vested restricted stock awards. Non-vested restricted stock awards are considered participating securities to the extent the holders of these securities receive non-forfeitable dividends at the same rate as holders of common stock. Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the dilutive effect of stock compensation using the treasury stock method. Stock options, where the exercise price was greater than the average market price of the common shares, were excluded from the computation of diluted earnings per common share because the result would have been antidilutive. Stock options of 33,000 and 49,763 were considered antidilutive as of March 31, 2011 and 2010. Stock warrants of 837,947 were considered antidilutive as of March 31, 2010. No stock warrants were outstanding as of March 31, 2011.

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The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted earnings per common share for the three months ended March 31, 2011 and 2010.

| (Dollars in thousands - except per share amounts) | Three Months Ended | |
|---|--------------------|------------|
| | March 31, | |
| | 2011 | 2010 |
| Distributed earnings allocated to common stock | \$ 3,888 | \$ 3,616 |
| Undistributed earnings allocated to common stock | 6,612 | 4,278 |
| Net earnings allocated to common stock | 10,500 | 7,894 |
| Net earnings allocated to participating securities | 108 | 74 |
| Net income allocated to common stock and participating securities | \$ 10,608 | \$ 7,968 |
| Weighted average shares outstanding for basic earnings per common share | 24,271,366 | 24,210,242 |
| Dilutive effect of stock compensation | 8,151 | 5,264 |
| Weighted average shares outstanding for diluted earnings per common share | 24,279,517 | 24,215,506 |
| Basic earnings per common share | \$ 0.43 | \$ 0.33 |
| Diluted earnings per common share | \$ 0.43 | \$ 0.33 |

Note 9. Stock-Based Compensation

As of March 31, 2011, we had four active stock-based employee compensation plans, which are more fully described in Note 16 of the Consolidated Financial Statements in 1st Source's Annual Report on Form 10-K for the year ended December 31, 2010. These plans include the 2001 Stock Option Plan, the Employee Stock Purchase Plan, the Executive Incentive Plan, and the Restricted Stock Award Plan.

Stock-based compensation expense for all stock-based compensation awards granted is based on the grant-date fair value. For all awards except stock option awards, the grant date fair value is either the fair market value per share or book value per share (corresponding to the type of stock awarded) as of the grant date. For stock option awards, the grant date fair value is estimated using the Black-Scholes option pricing model. For all awards we recognize these compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the award, for which we use the related vesting term. We estimate forfeiture rates based on historical employee option exercise and employee termination experience. We have identified separate groups of awardees that exhibit similar option exercise behavior and employee termination experience and have considered them as separate groups in the valuation models and expense estimates.

The stock-based compensation expense recognized in the condensed consolidated statement of income for the three months ended March 31, 2011 and 2010 was based on awards ultimately expected to vest, and accordingly has been adjusted by the amount of estimated forfeitures. GAAP requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based partially on historical experience.

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The aggregate intrinsic value in the table below represents the total pretax intrinsic value (the difference between 1st Source's closing stock price on the last trading day of the first quarter of 2011 (March 31, 2011) and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2011. This amount changes based on the fair market value of 1st Source's stock. Total fair value of options vested and expensed was \$3 thousand, net of tax, for both the three months ended March 31, 2011 and 2010.

| | Number of Shares | Weighted Average Exercise Price | Average Remaining Contractual Term (in years) | Total Intrinsic Value (in 000's) |
|---|---------------------|--|---|---|
| Options outstanding, beginning of year | 62,508 | \$ 17.18 | | |
| Granted | - | - | | |
| Exercised | - | - | | |
| Forfeited | (7,508) | 17.31 | | |
| Options outstanding, March 31, 2011 | 55,000 | \$ 17.16 | 1.01 | \$ 181 |
| | | | | |
| Vested and expected to vest at March 31, 2011 | 55,000 | \$ 17.16 | 1.01 | \$ 181 |
| Exercisable at March 31, 2011 | 52,250 | \$ 17.43 | 0.95 | \$ 159 |

No options were granted during the three months ended March 31, 2011.

As of March 31, 2011, there was \$5.00 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 3.72 years.

The following table summarizes information about stock options outstanding at March 31, 2011:

| Range of Exercise Prices | Number of shares Outstanding | Options Outstanding | | Options Exercisable | |
|--------------------------------|------------------------------------|---|--|------------------------------------|--|
| | | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number of shares Exercisable | Weighted Average Exercise Price |
| \$ 12.04 to \$17.99 | 22,000 | 2.06 | \$ 12.04 | 19,250 | \$ 12.04 |
| \$ 18.00 to \$26.99 | 33,000 | 0.31 | 20.58 | 33,000 | 20.58 |

The fair value of each stock option was estimated on the date of grant using the Black-Scholes option-pricing model.

Note 10. Income Taxes

The total amount of unrecognized tax benefits that would affect the effective tax rate if recognized was \$1.04 million at March 31, 2011 and \$1.52 million at December 31, 2010. Interest and penalties were recognized through the income tax provision. For the three months ending March 31, 2011 and the twelve months ending December 31, 2010, we recognized approximately \$(0.12) million and \$0.05 million in interest, net of tax effect, and penalties, respectively. Interest and penalties of approximately \$0.48 million and \$0.60 million were accrued at March 31, 2011 and December 31, 2010, respectively.

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Tax years that remain open and subject to audit include the federal 2007-2010 years and the Indiana 2007-2010 years. Additionally, during the first quarter of 2011 we reached a state tax settlement for the 2008 year and as a result recorded a reduction of unrecognized tax benefits in the amount of \$0.84 million that affected the effective tax rate and increased earnings in the amount of \$0.47 million. We do not anticipate a significant change in the amount of uncertain tax positions within the next 12 months.

Note 11. Fair Value Measurements

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

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

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

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

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

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

We elected fair value accounting for mortgages held for sale. We believe the election for mortgages held for sale (which are hedged with free-standing derivatives [economic hedges]) will reduce certain timing differences and better match changes in the value of these assets with changes in the value of derivatives used as economic hedges for these assets. At March 31, 2011 and December 31, 2010, all mortgages held for sale are carried at fair value.

The following table reflects the differences between fair value carrying amount of mortgages held for sale measured at fair value and the aggregate unpaid principal amount we are contractually entitled to receive at maturity on March 31, 2011:

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| (Dollars in thousands) | Fair value carrying amount | Aggregate unpaid principal | Excess of fair value carrying amount over (under) unpaid principal |
|---|----------------------------------|----------------------------------|---|
| Mortgages held for sale reported at fair value: | | | |
| Total loans | \$ 5,467 | \$ 5,307 | \$ 160 (1) |
| Nonaccrual loans | - | - | - |
| Loans 90 days or more past due and still accruing | - | - | - |

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

Financial Instruments on Recurring Basis:

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

Investment securities available for sale are valued primarily by a third party pricing agent and both the market and income valuation approaches are implemented using the following types of inputs:

U.S. treasuries are priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.

Government-sponsored agency debt securities and corporate bonds are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.

Other government-sponsored agency securities, mortgage-backed securities and some of the actively traded REMICs and CMOs, are primarily priced using available market information including benchmark yields, prepayment speeds, spreads and volatility of similar securities.

Other inactive government-sponsored agency securities are primarily priced using consensus pricing and dealer quotes.

State and political subdivisions are largely grouped by characteristics, i.e., geographical data and source of revenue in trade dissemination systems. Since some securities are not traded daily and due to other grouping limitations, active market quotes are often obtained using benchmarking for like securities. Local tax anticipation warrants, with very little market activity, are priced using an appropriate market yield curve.

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

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

Mortgages held for sale and the related loan commitments and forward contracts (hedges) are valued using a market value approach and utilizing an appropriate current market yield and a loan commitment closing rate based on historical analysis.

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Interest rate swap positions, both assets and liabilities, are valued by a third-party pricing agent using an income approach and utilizing models that use as their basis readily observable market parameters. This valuation process considers various factors including interest rate yield curves, time value and volatility factors. Management believes an adjustment is required to “mid-market” valuations for derivatives tied to its performing loan portfolio to recognize the imprecision and related exposure inherent in the process of estimating credit losses as well as velocity of deterioration evident with systemic risks imbedded in these portfolios.

The table below presents the balance of assets and liabilities at March 31, 2011, measured at fair value on a recurring basis:

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|--|------------------|-------------------|------------------|-------------------|
| Assets: | | | | |
| Investment securities available-for-sale: | | | | |
| U.S. Treasury and Federal agencies securities | \$ 20,159 | \$ 417,484 | \$ - | \$ 437,643 |
| U.S. States and political subdivisions securities | - | 107,326 | 16,538 | 123,864 |
| Mortgage-backed securities – Federal agencies | - | 333,758 | - | 333,758 |
| Corporate debt securities | - | 35,595 | - | 35,595 |
| Foreign government and other securities | - | 6,014 | 675 | 6,689 |
| Total debt securities | 20,159 | 900,177 | 17,213 | 937,549 |
| Marketable equity securities | 4,672 | - | - | 4,672 |
| Total investment securities available-for-sale | 24,831 | 900,177 | 17,213 | 942,221 |
| Trading account securities | 146 | - | - | 146 |
| Mortgages held for sale | - | 5,467 | - | 5,467 |
| Accrued income and other assets (Interest rate swap agreements) | - | 12,391 | - | 12,391 |
| Total | \$ 24,977 | \$ 918,035 | \$ 17,213 | \$ 960,225 |
| Liabilities | | | | |
| Accrued expenses and other liabilities (Interest rate swap agreements) | \$ - | \$ 12,781 | \$ - | \$ 12,781 |
| Total | \$ - | \$ 12,781 | \$ - | \$ 12,781 |

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the quarter ended March 31, 2011 are summarized as follows:

| (Dollars in thousands) | U.S. States and political subdivisions securities | Corporate debt securities | Foreign government and other securities | Investment securities available-for-sale |
|---|---|---------------------------|---|--|
| Beginning balance January 1, 2011 | \$ 16,306 | \$ 9,992 | \$ 675 | \$ 26,973 |
| Total gains or losses (realized/unrealized): | | | | |
| Included in earnings | - | - | - | - |
| Included in other comprehensive income | 577 | - | - | 577 |
| Purchases | 350 | - | - | 350 |

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| | | | | |
|-------------------------------|-----------|----------|--------|-----------|
| Issuances | - | - | - | - |
| Settlements | - | - | - | - |
| Maturities | (695) | (9,992) | - | (10,687) |
| Transfers into Level 3 | - | - | - | - |
| Transfers out of Level 3 | - | - | - | - |
| Ending balance March 31, 2011 | \$ 16,538 | \$ - | \$ 675 | \$ 17,213 |

There were no gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at March 31, 2011.

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Financial Instruments on Non-recurring Basis:

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

Impaired loans and related write-downs are based on the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are reviewed quarterly and estimated using customized discounting criteria, appraisals and dealer and trade magazine quotes which are used in a market valuation approach.

Partnership investments and the adjustments to fair value primarily result from application of lower of cost or fair value accounting. The partnership investments are priced using financial statements provided by the partnerships.

Mortgage servicing rights (MSRs) and related adjustments to fair value result from application of lower of cost or fair value accounting. For purposes of impairment, MSRs are stratified based on the predominant risk characteristics of the underlying servicing, principally by loan type and interest rate. The fair value of each tranche of the servicing portfolio is estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors. A fair value analysis is also obtained from an independent third party agent. MSRs do not trade in an active, open market with readily observable prices and though sales of MSRs do occur, precise terms and conditions typically are not readily available and the characteristics of our servicing portfolio may differ from those of any servicing portfolios that do trade.

Other real estate is based on the lower of cost or fair value of the underlying collateral less expected selling costs. Collateral values are estimated primarily using appraisals and reflect a market value approach. New appraisals are obtained annually. Repossessions are similarly valued.

For assets measured at fair value on a nonrecurring basis the following represents impairment charges (recoveries) recognized on these assets during the quarter ended March 31, 2011: impaired loans - \$0.50 million; partnership investments – \$(0.12) million; mortgage servicing rights - \$0.00 million; repossessions - \$0.18 million, and other real estate - \$0.08 million.

The table below presents the carrying value of assets at March 31, 2011, measured at fair value on a non-recurring basis:

| (Dollars in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|-----------|-----------|
| Loans | \$ - | \$ - | \$ 75,472 | \$ 75,472 |
| Accrued income and other assets (partnership investments) | - | - | 2,006 | 2,006 |
| Accrued income and other assets (mortgage servicing rights) | - | - | 6,963 | 6,963 |
| Accrued income and other assets (repossessions) | - | - | 5,482 | 5,482 |
| Accrued income and other assets (other real estate) | - | - | 8,013 | 8,013 |
| | \$ - | \$ - | \$ 97,936 | \$ 97,936 |

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

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The fair values of our financial instruments as of March 31, 2011, and December 31, 2010, are summarized in the table below.

| (Dollars in thousands) | March 31, 2011 | | December 31, 2010 | |
|---|----------------------------|--------------|----------------------------|--------------|
| | Carrying or Contract Value | Fair Value | Carrying or Contract Value | Fair Value |
| Assets: | | | | |
| Cash and due from banks | \$ 57,271 | \$ 57,271 | \$ 62,313 | \$ 62,313 |
| Federal funds sold and interest bearing deposits with other banks | 81,661 | 81,661 | 34,559 | 34,559 |
| Investment securities, available-for-sale | 942,221 | 942,221 | 969,018 | 969,018 |
| Other investments and trading account securities | 20,649 | 20,649 | 21,481 | 21,481 |
| Mortgages held for sale | 5,467 | 5,467 | 32,599 | 32,599 |
| Loans and leases, net of reserve for loan and lease losses | 2,965,558 | 3,076,930 | 2,983,749 | 3,040,895 |
| Cash surrender value of life insurance policies | 53,599 | 53,599 | 54,182 | 54,182 |
| Mortgage servicing rights | 6,963 | 10,194 | 7,556 | 8,785 |
| Interest rate swaps | 12,391 | 12,391 | 14,959 | 14,959 |
| Liabilities: | | | | |
| Deposits | \$ 3,609,007 | \$ 3,636,660 | \$ 3,622,745 | \$ 3,654,067 |
| Short-term borrowings | 132,153 | 132,153 | 155,989 | 155,989 |
| Long-term debt and mandatorily redeemable securities | 26,717 | 26,955 | 24,816 | 25,072 |
| Subordinated notes | 89,692 | 87,951 | 89,692 | 79,811 |
| Interest rate swaps | 12,781 | 12,781 | 15,384 | 15,384 |
| Off-balance-sheet instruments * | - | 146 | - | 134 |

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

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

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

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

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

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

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Subordinated Notes — Fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated based on calculated market prices of comparable securities.

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

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

These estimates do not reflect any premium or discount that could result from offering for sale at one time our entire holdings of a particular financial instrument. These estimates are subjective in nature and require considerable judgment to interpret market data. Accordingly, the estimates presented herein are not necessarily indicative of the amounts we could realize in a current market exchange, nor are they intended to represent the fair value of 1st Source as a whole. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of the respective balance sheet date. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein.

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

Note 12. Subsequent Events

We have evaluated subsequent events through the date our financial statements were issued. We do not believe any subsequent events have occurred that would require further disclosure or adjustment to our financial statements.

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical information contained herein, the matters discussed in this document express "forward-looking statements." Generally, the words "believe," "contemplate," "seek," "plan," "possible," "assume," "expect," "intend," "target," "continue," "remain," "estimate," "anticipate," "project," "will," "should," "indicate," "would," "may" and similar expressions are used to identify forward-looking statements. Those statements, including statements, projections, estimates or assumptions concerning future events or performance, and other statements that are other than statements of historical fact, are subject to material risks and uncertainties. We caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made. We may make other written or oral forward-looking statements from time to time. Readers are advised that various important factors could cause our actual results or circumstances for future periods to differ

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materially from those anticipated or projected in such forward-looking statements. Such factors include, but are not limited to, changes in law, regulations or U.S. generally accepted accounting principles; our competitive position within the markets we serve; increasing consolidation within the banking industry; unforeseen changes in interest rates; unforeseen changes in loan prepayment assumptions; unforeseen downturns in or major events affecting the local, regional or national economies or the industries in which we have credit concentrations; and other matters discussed in our filings with the SEC, including our Annual Report on Form 10-K for 2010, which filings are available from the SEC. We undertake no obligation to publicly update or revise any forward-looking statements.

The following management's discussion and analysis is presented to provide information concerning our financial condition as of March 31, 2011, as compared to December 31, 2010, and the results of operations for the three months ended March 31, 2011 and 2010. This discussion and analysis should be read in conjunction with our consolidated financial statements and the financial and statistical data appearing elsewhere in this report and our 2010 Annual Report.

FINANCIAL CONDITION

Our total assets at March 31, 2011, were \$4.41 billion, a decrease of \$32.91 million or 0.74% from December 31, 2010. Total loans and leases were \$3.05 billion, a decrease of \$18.91 million or 0.62% from December 31, 2010. Fed funds sold and interest bearing deposits with other banks were \$81.66 million, an increase of \$47.10 million or 136.29% from December 31, 2010. Total investment securities, available for sale were \$942.22 million which represented a decrease of \$26.80 million or 2.77% and total deposits were \$3.61 billion, a decrease of \$13.74 million or 0.38% over the comparable figures at the end of 2010.

Nonperforming assets at March 31, 2011, were \$88.35 million, which was a decrease of \$0.36 million or 0.41% from the \$88.71 million reported at December 31, 2010. At March 31, 2011 and December 31, 2010, nonperforming assets were 2.81% of net loans and leases.

Accrued income and other assets were as follows:

| (Dollars in thousands) | March 31, 2011 | December 31, 2010 |
|--|-------------------|----------------------|
| Accrued income and other assets: | | |
| Bank owned life insurance cash surrender value | \$ 53,599 | \$ 54,182 |
| Accrued interest receivable | 14,334 | 14,218 |
| Mortgage servicing assets | 6,963 | 7,556 |
| Other real estate | 6,813 | 6,392 |
| Former bank premises held for sale | 1,200 | 1,200 |
| Repossessions | 5,482 | 5,670 |
| All other assets | 45,180 | 51,370 |
| Total accrued income and other assets | \$ 133,571 | \$ 140,588 |

CAPITAL

As of March 31, 2011, total shareholders' equity was \$490.47 million, up \$4.08 million or 0.84% from the \$486.38 million at December 31, 2010. In addition to net income of \$10.61 million, other significant changes in shareholders' equity during the first three months of 2011 included \$3.90 million of dividends paid and \$3.75 million of a common stock warrant repurchased. The accumulated other comprehensive income/(loss) component of shareholders' equity totaled \$9.13 million at March 31, 2011, compared to \$10.51 million at December 31, 2010. The decrease in

accumulated other comprehensive income/(loss) during 2011 was primarily a result of changes in unrealized gain/(loss) on securities in the available-for-sale portfolio. Our equity-to-assets ratio was 11.12% as of March 31, 2011, compared to 10.94% at December 31, 2010. Book value per common share rose to \$20.18 at March 31, 2011, from \$20.12 at December 31, 2010.

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We declared and paid dividends per common share of \$0.16 during the first quarter of 2011. The trailing four quarters dividend payout ratio, representing dividends per common share divided by diluted earnings per common share, was 47.33%. The dividend payout is continually reviewed by management and the Board of Directors subject to the Corporation's capital and dividend policy.

The banking regulators have established guidelines for leverage capital requirements, expressed in terms of Tier 1 or core capital as a percentage of average assets, to measure the soundness of a financial institution. In addition, banking regulators have established risk-based capital guidelines for U.S. banking organizations. The actual capital amounts and ratios of 1st Source Corporation and 1st Source Bank as of March 31, 2011, are presented in the table below:

| (Dollars in thousands) | Actual | | Minimum Capital Adequacy | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|------------|---------|--------------------------|--------|--|---------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital (to Risk-Weighted Assets): | | | | | | |
| 1st Source Corporation | | | | | | |
| | \$ 522,933 | 15.68 % | \$ 266,750 | 8.00 % | \$ 333,438 | 10.00 % |
| 1st Source Bank | | | | | | |
| | 516,652 | 15.55 | 265,845 | 8.00 | 332,306 | 10.00 |
| Tier 1 Capital (to Risk-Weighted Assets): | | | | | | |
| 1st Source Corporation | | | | | | |
| | 479,637 | 14.38 | 133,375 | 4.00 | 200,063 | 6.00 |
| 1st Source Bank | | | | | | |
| | 474,425 | 14.28 | 132,922 | 4.00 | 199,383 | 6.00 |
| Tier 1 Capital (to Average Assets): | | | | | | |
| 1st Source Corporation | | | | | | |
| | 479,637 | 11.07 | 173,272 | 4.00 | 216,589 | 5.00 |
| 1st Source Bank | | | | | | |
| | 474,425 | 10.99 | 172,682 | 4.00 | 215,852 | 5.00 |

LIQUIDITY AND INTEREST RATE SENSITIVITY

Effective liquidity management ensures that the cash flow requirements of depositors and borrowers, as well as the operating cash needs of 1st Source Corporation, are met. Funds are available from a number of sources, including the securities portfolio, the core deposit base, Federal Home Loan Bank (FHLB) borrowings, Federal Reserve Bank (FRB) borrowings, and the capability to package loans for sale.

We have borrowing sources available to supplement deposits and meet our funding needs. 1st Source Bank has established relationships with several banks to provide short term borrowings in the form of federal funds purchased. While at March 31, 2011 there were no amounts outstanding, management believes we could borrow approximately \$255.00 million for a short time from these banks on a collective basis. As of March 31, 2011, the Bank had \$15.93 million outstanding in FHLB advances and could borrow an additional \$208.46 million. We also had \$330.99 million available to borrow from the FRB with no amounts outstanding as of March 31, 2011.

Our loan to asset ratio was 69.16% at March 31, 2011 compared to 69.08% at December 31, 2010 and 69.88% at March 31, 2010. Cash and cash equivalents totaled \$57.27 million at March 31, 2011 compared to \$62.31 million at December 31, 2010 and \$53.52 million at March 31, 2010. At March 31, 2011, the consolidated statement of

financial condition was rate sensitive by \$344.33 million more liabilities than assets scheduled to reprice within one year, or approximately 0.87%. Management believes that the present funding sources provide adequate liquidity to meet our cash flow needs.

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In addition, the State of Indiana recently changed the law governing the collateralization of public fund deposits. Under the new law, the Indiana Board of Depositories will determine what financial institutions are required to pledge collateral. We have been informed that no collateral is necessary through March 31, 2011 for our Indiana public fund deposits. However, pending legislation could alter this requirement in the future. Our potential liquidity exposure if we must pledge collateral is approximately \$600.00 million.

RESULTS OF OPERATIONS

Net income for the three month period ended March 31, 2011 was \$10.61 million, compared to \$9.68 million for the same period in 2010. Diluted net income per common share was \$0.43 for the three month period ended March 31, 2011, compared to \$0.33 for the same period in 2010. Return on average common shareholders' equity was 8.73% for the three months ended March 31, 2011, compared to 6.82% in 2010. The return on total average assets was 0.97% for the three months ended March 31, 2011, compared to 0.88% in 2010.

The increase in net income for the three months ended March 31, 2011, over the first three months of 2010, was primarily the result of a decrease in provision for loan and lease losses and an increase in net interest income. This positive impact to net income was partially offset by an increase in noninterest expense and a decrease in noninterest income. Details of the changes in the various components of net income are discussed further below.

NET INTEREST INCOME

The taxable equivalent net interest income for the three months ended March 31, 2011 was \$37.57 million, an increase of 5.00% over the same period in 2010. The net interest margin on a fully taxable equivalent basis was 3.71% for the three months ended March 31, 2011, compared to 3.50% for the three months ended March 31, 2010.

During the three month period ended March 31, 2011, average earning assets decreased \$36.96 million or 0.89% over the comparable period in 2010. Average interest-bearing liabilities decreased \$48.06 million or 1.41% for the three month period ended March 31, 2011 over the comparable period one year ago. The yield on average earning assets decreased 19 basis points to 4.73% for the first quarter of 2011 from 4.92% for the first quarter of 2010. The rate earned on assets decreased due to the reduction in short-term market interest rates from a year ago. Total cost of average interest-bearing liabilities decreased 48 basis points to 1.25% for the first quarter 2011 from 1.73% for the first quarter 2010. The result to the net interest margin, or the difference between interest income on earning assets and interest expense on interest-bearing liabilities, was an increase of 21 basis points for the three month period ended March 31, 2011 from March 31, 2010.

The largest contributor to the decrease in the yield on average earning assets for the three months ended March 31, 2011, compared to the three months ended March 31, 2010, was a reduction in yields on taxable investment securities of 84 basis points. Total average investment securities increased \$63.96 million or 7.17% for the three month period over one year ago. Average mortgages held for sale decreased \$3.42 million or 16.58% for the three month period ended March 31, 2011, over the comparable periods a year ago due to the elimination of our wholesale broker activity. Average net loans and leases decreased \$46.13 million or 1.49% for the first quarter of 2011 from the first quarter of 2010. Average other investments, which include federal funds sold, time deposits with other banks, Federal Reserve Bank excess balances, Federal Reserve Bank and Federal Home Loan Bank stock and commercial paper, decreased \$51.37 million or 38.82% for the three month period ended March 31, 2011, over the comparable period a year ago.

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Average interest-bearing deposits decreased \$41.49 million or 1.33%, for the first quarter of 2011 over the same period in 2010. The effective rate paid on average interest-bearing deposits decreased 51 basis points to 1.10% for the first quarter 2011 compared to 1.61% for the first quarter 2010. The decline in the average cost of interest-bearing deposits during the first quarter of 2011 as compared to the first quarter of 2010 was primarily the result of interest rate re-pricing on maturing certificates of deposit.

Average short-term borrowings decreased \$11.92 million or 7.42% for the first quarter of 2011, compared to the same period in 2010. The decrease in average short-term borrowings was primarily due to lower repurchase agreements and lower secured borrowings. Interest paid on short-term borrowings decreased 23 basis points for the first quarter of 2011 due to the interest rate decrease on adjustable rate borrowings. Average long-term debt increased \$5.36 million or 26.69% during the first quarter of 2011 as compared to the first quarter of 2010. The increase in long-term borrowings was the result of higher borrowings with the Federal Home Loan Bank offset by lower borrowings on a line of credit. Interest paid on long-term borrowings decreased 133 basis points for the first quarter due to lower effective rates on new Federal Home Loan Bank borrowings.

The following table provides an analysis of net interest income and illustrates the interest earned and interest expense charged for each major component of interest-earning assets and 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.

**DISTRIBUTION OF ASSETS, LIABILITIES AND SHAREHOLDERS' EQUITY
INTEREST RATES AND INTEREST DIFFERENTIAL**

(Dollars in thousands)

| | Three months ended March 31, | | | | | |
|--------------------------------------|------------------------------|--------------------------------|----------------|---------------------|--------------------------------|----------------|
| | 2011 | | | 2010 | | |
| | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate |
| ASSETS: | | | | | | |
| Investment securities: | | | | | | |
| Taxable | \$ 815,564 | \$ 4,482 | 2.23 % | \$ 712,824 | \$ 5,401 | 3.07 % |
| Tax exempt | 141,004 | 1,734 | 4.99 % | 179,782 | 2,145 | 4.84 % |
| Mortgages - held for sale | 17,213 | 179 | 4.22 % | 20,634 | 273 | 5.37 % |
| Net loans and leases | 3,054,013 | 41,278 | 5.48 % | 3,100,144 | 42,194 | 5.52 % |
| Other investments | 80,949 | 243 | 1.22 % | 132,323 | 274 | 0.84 % |
| Total Earning Assets | 4,108,743 | 47,916 | 4.73 % | 4,145,707 | 50,287 | 4.92 % |
| Cash and due from banks | 58,710 | | | 57,891 | | |
| Reserve for loan and lease losses | (88,263) | | | (89,223) | | |
| Other assets | 340,974 | | | 371,019 | | |
| Total | \$ 4,420,164 | | | \$ 4,485,394 | | |

**LIABILITIES AND SHAREHOLDERS'
EQUITY:**

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| | | | | | | |
|--|---------------------|------------------|---------------|---------------------|------------------|---------------|
| Interest-bearing deposits | \$ 3,084,779 | \$ 8,355 | 1.10 % | \$ 3,126,268 | \$ 12,405 | 1.61 % |
| Short-term borrowings | 148,729 | 89 | 0.24 % | 160,652 | 188 | 0.47 % |
| Subordinated notes | 89,692 | 1,647 | 7.45 % | 89,692 | 1,647 | 7.45 % |
| Long-term debt and mandatorily redeemable securities | 25,426 | 259 | 4.13 % | 20,070 | 270 | 5.46 % |
| Total Interest-Bearing Liabilities | 3,348,626 | 10,350 | 1.25 % | 3,396,682 | 14,510 | 1.73 % |
| Noninterest-bearing deposits | 515,236 | | | 447,861 | | |
| Other liabilities | 63,629 | | | 62,239 | | |
| Shareholders' equity | 492,673 | | | 578,612 | | |
| Total | \$ 4,420,164 | | | \$ 4,485,394 | | |
| Net Interest Income | | \$ 37,566 | | | \$ 35,777 | |
| Net Yield on Earning Assets on a Taxable Equivalent Basis | | | 3.71 % | | | 3.50 % |

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PROVISION AND RESERVE FOR LOAN AND LEASE LOSSES

The provision for loan and lease losses for the three month period ended March 31, 2011 was \$2.20 million, compared to a provision for loan and lease losses in the three month period ended March 31, 2010 of \$4.39 million. Net charge-offs of \$2.91 million were recorded for the first quarter 2011, compared to \$4.80 million for the same quarter a year ago.

On March 31, 2011, 30 day and over loan and lease delinquencies were 0.56% as compared to 0.84% on March 31, 2010. The decrease in delinquencies was primarily in construction equipment, auto, light truck and environmental equipment and commercial loans. The reserve for loan and lease losses as a percentage of loans and leases outstanding at the end of the period was 2.82% as compared to 2.83% one year ago. A summary of loan and lease loss experience during the three months ended March 31, 2011 and 2010 is located in Note 5 of the Consolidated Financial Statements.

A loan or lease is considered impaired, based on current information and events, if it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan or lease agreement. We evaluate loans and leases exceeding \$100,000 for impairment and establish an allowance as a component of the reserve for loan and lease losses when it is probable all amounts due will not be collected pursuant to the contractual terms of the loan and lease and the recorded investment in the loan or lease exceeds its fair value.

NONPERFORMING ASSETS

Nonperforming assets were as follows:

(Dollars in thousands)

| | March 31, 2011 | December 31, 2010 | March 31, 2010 |
|---|-------------------|----------------------|-------------------|
| Loans and leases past due 90 days or more | \$ 515 | \$ 361 | \$ 272 |
| Nonaccrual loans and leases | 74,038 | 74,853 | 78,094 |
| Other real estate | 6,813 | 6,392 | 5,205 |
| Former bank premises held for sale | 1,200 | 1,200 | 2,363 |
| Repossessions | 5,482 | 5,670 | 9,886 |
| Equipment owned under operating leases | 300 | 236 | 150 |
| Total nonperforming assets | \$ 88,348 | \$ 88,712 | \$ 95,970 |

Nonperforming assets as a percentage of total loans and leases were 2.81% at March 31, 2011 and December 31, 2010, and 2.98% at March 31, 2010. Nonperforming assets totaled \$88.35 million at March 31, 2011, a decrease of 0.41% from the \$88.71 million reported at December 31, 2010, and a 7.94% decrease from the \$95.97 million reported at March 31, 2010. The decrease during the first three months of 2011 compared to the same period in 2010 was primarily related to decreases in nonaccrual loans and leases and repossessions as the economy slowly improves.

The decrease in nonaccrual loans and leases at March 31, 2011 from March 31, 2010 was spread among the various loan portfolios except for increases in aircraft. The largest dollar decrease at March 31, 2011 from December 31, 2010 occurred in the aircraft portfolio, with notable decreases also occurring in the medium and heavy duty truck and construction equipment portfolios, and was offset by increases in commercial real estate loans. A summary of

nonaccrual loans and leases and past due aging for the period ended March 31, 2011 and December 31, 2010 is located in Note 4 of the Consolidated Financial Statements.

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As of March 31, 2011, the industry with the largest dollar exposure was with borrowers whose primary source of income was derived from commercial real estate. These impaired loans totaled approximately \$27.59 million which were comprised of \$21.02 million secured by commercial real estate and included in loans secured by real estate and \$6.57 million secured by aircraft and included in aircraft financing. We have limited exposure to commercial real estate. However, our borrowers with commercial real estate exposure, whether local real estate developers in our commercial portfolio or customers in our niche portfolios such as aircraft whose underlying business is dependent on developing, marketing and managing real estate properties, have suffered as a result of declining real estate values and minimal sales activity. Furthermore, aircraft values declined during 2009 and 2010, increasing the risk in aircraft secured transactions.

The increase over the past year in other real estate is due to foreclosing on real estate in the local market for which we have a current appraisal and is well secured.

Repossessions consisted mainly of aircraft at March 31, 2011. At the time of repossession, the recorded amount of the loan or lease is written down, if necessary, to the estimated value of the equipment or vehicle by a charge to the reserve for loan and lease losses, unless the equipment is in the process of immediate sale. Any subsequent write-downs are included in noninterest expense.

A summary of other real estate and repossessions as of March 31, 2011 and 2010 is shown in the table below:

| (Dollars in thousands) | 2011 | March 31, 2010 |
|---|------------------|-------------------|
| Commercial and agricultural loans | \$ - | \$ 146 |
| Auto, light truck and environmental equipment | 261 | 325 |
| Medium and heavy duty truck | 60 | 315 |
| Aircraft financing | 4,946 | 8,858 |
| Construction equipment financing | 200 | 195 |
| Commercial real estate | 6,083 | 4,475 |
| Residential real estate | 730 | 730 |
| Consumer loans | 15 | 47 |
| Total | \$ 12,295 | \$ 15,091 |

For financial statement purposes, nonaccrual loans and leases are included in loan and lease outstandings, whereas repossessions and other real estate are included in other assets.

Foreign Outstandings — Our foreign loan and lease outstandings, all denominated in U.S. dollars were \$205.03 million and \$201.03 million as of March 31, 2011 and December 31, 2010, respectively. Foreign loans and leases are in aircraft financing. Loan and lease outstandings to borrowers in Brazil and Mexico were \$145.09 million and \$36.87 million as of March 31, 2011, respectively, compared to \$134.34 million and \$34.03 million as of December 31, 2010, respectively. Outstanding balances to borrowers in other countries were insignificant.

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NONINTEREST INCOME

Noninterest income for the three month period ended March 31, 2011 and 2010 was \$18.95 million and \$20.92 million, respectively. Details of noninterest income follow:

| (Dollars in thousands) | Three Months Ended March 31, | |
|--|---------------------------------|------------------|
| | 2011 | 2010 |
| Noninterest income: | | |
| Trust fees | \$ 3,992 | \$ 3,745 |
| Service charges on deposit accounts | 4,236 | 4,620 |
| Mortgage banking income | 444 | 777 |
| Insurance commissions | 1,142 | 1,465 |
| Equipment rental income | 6,038 | 6,745 |
| Other income | 2,971 | 2,689 |
| Investment securities and other investment gains | 130 | 881 |
| Total noninterest income | \$ 18,953 | \$ 20,922 |

Noninterest income decreased in all categories for the first quarter 2011 as compared to the same period in 2010 except trust fees and other income.

Trust fees increased \$0.25 million or 6.60% for the three month period ended March 31, 2011 over the three month period ended March 31, 2010. The increase in trust fees was a result of an increase in market values of investment accounts.

Service charges on deposit accounts decreased \$0.38 million or 8.31% for the three months ended March 31, 2011 over the comparable period one year ago. The decline in service charges on deposit accounts reflects a lower volume of nonsufficient fund transactions.

Mortgage banking income decreased \$0.33 million or 42.86% in the first quarter of 2011 as compared to the first quarter of 2010. The first quarter decrease was due to lower gains on loan sales.

Insurance commissions decreased \$0.32 million or 22.05% in the three months ended March 31, 2011 over the same period a year ago. The decrease was due to reduced contingent commissions, primarily as a result of a high level of claims activity in our books of business. We also experienced a loss of commercial business premiums in the Fort Wayne market due to declines in business relationships.

Equipment rental income declined \$0.71 million or 10.48% in the first quarter of 2011 compared to the first quarter 2010. The average equipment rental portfolio decreased 9.65% in 2011 over the same period in 2010 resulting in lower rental income.

Other income increased \$0.28 million or 10.49% for the three month period ended March 31, 2011 as compared to the same period in 2010, mainly due to higher earnout fees on the sale of assets of 1st Source Investment Advisors related to the management of the 1st Source Monogram Funds.

The decrease in investment securities and other investments gains of \$0.75 million or 85.24% in the three months ended March 31, 2011 was due to a loss on a venture capital investment and lower partnership investment gains in

2011 compared to the same period a year earlier.

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NONINTEREST EXPENSE

Noninterest expense for the three month period ended March 31, 2011 and 2010 was \$38.48 million and \$37.11 million, respectively. Details of noninterest expense follow:

| (Dollars in thousands) | Three Months Ended March 31, | |
|--|---------------------------------|------------------|
| | 2011 | 2010 |
| Noninterest expense: | | |
| Salaries and employee benefits | \$ 18,638 | \$ 18,810 |
| Net occupancy expense | 2,320 | 2,487 |
| Furniture and equipment expense | 3,349 | 2,800 |
| Depreciation - leased equipment | 4,805 | 5,364 |
| Professional fees | 1,096 | 1,514 |
| Supplies and communication | 1,394 | 1,369 |
| Business development and marketing expense | 622 | 567 |
| Intangible asset amortization | 325 | 330 |
| Loan and lease collection and repossession expense | 1,324 | 1,106 |
| FDIC and other insurance | 1,676 | 1,674 |
| Other expense | 2,927 | 1,089 |
| Total noninterest expense | \$ 38,476 | \$ 37,110 |

During the first quarter 2011, furniture and equipment expense increased \$0.55 million or 19.61% compared to the first quarter 2010. The higher expense was mainly due to computer processing charges.

Depreciation on leased equipment decreased \$0.56 million or 10.42% in conjunction with the decrease in equipment rental income for the three months ended March 31, 2011 as compared to the same period one year ago.

Professional fees decreased \$0.42 million or 27.61% for the three month period ended March 31, 2011 as compared to the three month period ended March 31, 2010. The reduction in professional fees in 2011 was the result of lower consulting fees.

Loan and lease collection and repossession expense increased \$0.22 million or 19.71% for the first quarter of 2011 as compared to the same period in 2010 mainly due to increased operating costs on other real estate owned and overall increased collection and repossession activity.

Other expenses increased \$1.84 million or 168.78% in the three months ended March 31, 2011 as compared to the three months ended March 31, 2010. The increase was primarily due to a charge of \$1.68 million for provision on unfunded loan commitments.

Salaries and employee benefits, net occupancy, supplies and communication, business development and marketing, intangible asset amortization, and FDIC and other insurance expense all changed slightly in 2011 over the same period in 2010.

INCOME TAXES

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The provision for income taxes for the three month period ended March 31, 2011 was \$4.53 million, compared to \$4.65 million for the same period in 2010. The effective tax rates were 29.93% and 32.44% for the first quarter ended March 31, 2011 and 2010, respectively. Additionally, during the first quarter of 2011 we reached a state tax settlement for the 2008 year and as a result recorded a reduction of unrecognized tax benefits in the amount of \$0.84 million that affected the effective tax rate and increased earnings in the amount of \$0.47 million.

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ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risks faced by 1st Source since December 31, 2010. For information regarding our market risk, refer to 1st Source's Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 4.

CONTROLS AND PROCEDURES

As of the end of the period covered by this report an evaluation was carried out, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, at March 31, 2011, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by 1st Source in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

In addition, there were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the first fiscal quarter of 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM Legal Proceedings.

1.

1st Source and its 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.

We note that we received notice in April 2011 that the United States Department of Justice has initiated an investigation of 1st Source prompted by pricing practices of certain brokers from whom we purchased mortgages in prior years that were originated by them. The investigation is pursuant to the Equal Credit Opportunity Act and Fair Housing Act. As previously disclosed, we ended our relationships with third-party mortgage brokers in 2010. We are cooperating fully with the investigation and, based on our present understanding, do not expect an outcome that would have any material adverse effect on our consolidated financial position or results of operations.

ITEM Risk Factors.

1A.

There have been no material changes in risks faced by 1st Source since December 31, 2010. For information regarding our risk factors, refer to 1st Source's Annual Report on Form 10-K for the year ended December 31, 2010.

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ITEM Unregistered Sales of Equity Securities and Use of Proceeds
2.

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs (1) | Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs |
|---------------------------|---|---------------------------------------|--|---|
| January 01 - 31, 2011 - | | \$ - | - | 1,238,372 |
| February 01 - 28, 2011 | 1,900 | 18.50 | 1,900 | 1,236,472 |
| March 01 - 31, 2011 | 7,000 | 18.35 | 7,000 | 1,229,472 |

(1) 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 770,528 shares.

ITEM Defaults Upon Senior Securities.
3.

None

ITEM (Removed and reserved).
4.

ITEM Other Information.
5.

None

ITEM Exhibits
6.

The following exhibits are filed with this report:

31.1 Certification of Chief Executive Officer required by Rule 13a-14(a).

31.2 Certification of Chief Financial Officer required by Rule 13a-14(a).

32.1 Certification pursuant to 18 U.S.C. Section 1350 of Chief Executive Officer.

32.2 Certification pursuant to 18 U.S.C. Section 1350 of Chief Financial Officer.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

1st Source Corporation

DATE April 21, 2011

/s/CHRISTOPHER J. MURPHY III
Christopher J. Murphy III
Chairman of the Board, President and CEO

DATE April 21, 2011

/s/LARRY E. LENTYCH
Larry E. Lentych
Treasurer and Chief Financial Officer
Principal Accounting Officer

