2020 ANNUAL REPORT

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STRAIGHT TALK *and* SOUND ADVICE — SINCE 1863 — *Guaranteed*

Strong. Stable. Local. Personal. We are a top-rated community bank recognized for outstanding performance and exceptional service to clients.

Staying true to our values has helped us succeed. Integrity; outstanding client service; teamwork; superior quality; and community leadership are at the heart of everything we do. We adhere to solid, basic lending principles, allowing us to maintain a strong financial standing.

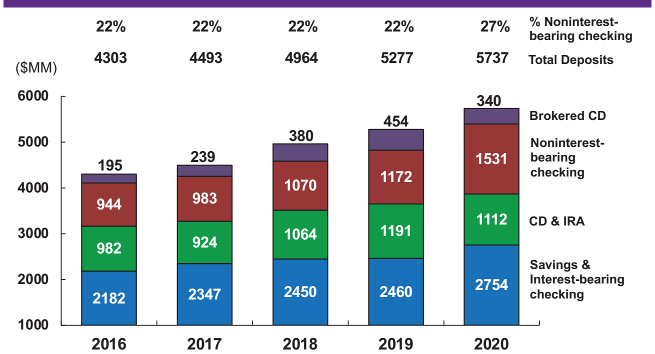
1st Source Corporation

CORPORATE DESCRIPTION

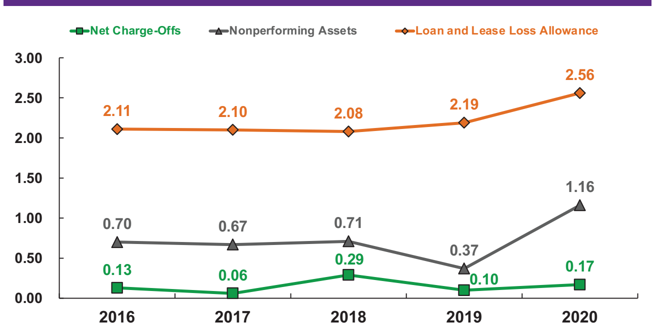
1st Source Corporation is the largest locally controlled financial institution headquartered in the northern Indiana-southwestern Michigan area serving the region since 1863. While delivering a comprehensive range of consumer, commercial and digital banking services, 1st Source has distinguished itself with highly personalized services and distinctive convenience. 1st Source also provides specialized financing nationally for new and used private and cargo aircraft, automobiles and light trucks for leasing and rental agencies, medium and heavy duty trucks, and construction equipment.

The Corporation has 79 banking centers in 18 counties in Indiana, Michigan and one county in Florida, ten 1st Source Insurance offices, eight Wealth Advisory Services locations, and 18 locations nationwide for the 1st Source Specialty Finance Group. 1st Source is proud of its tradition of providing superior service to clients while playing a leadership role in the continued development of the communities it serves.

Average Deposits



Loan and Lease Quality (% of Loans and Leases)



Net Income Summary

(000s)	2020	2019	$ Change	% Change
Net interest income	$225,820	$223,866	1,954	0.9 %
Provision for credit losses	36,001	15,833	20,168	127.4 %
Net interest income after provision	189,819	208,033	(18,214)	(8.8)%
Noninterest income*	83,686	76,002	7,684	10.1 %
Noninterest expense*	167,164	163,881	3,283	2.0 %
Income before income taxes	106,341	120,154	(13,813)	(11.5)%
Income tax expense	24,880	28,139	(3,259)	(11.6)%
Net income	**81,461**	**92,015**	**(10,554)**	**(11.5)%**
Net income attributable to noncontrolling interests	(24)	(55)	(31)	(56.4)%
Net income available to common shareholders	**$ 81,437**	**$ 91,960**	**(10,523)**	**(11.4)%**

* Excludes leased equipment depreciation

2020 In Brief:

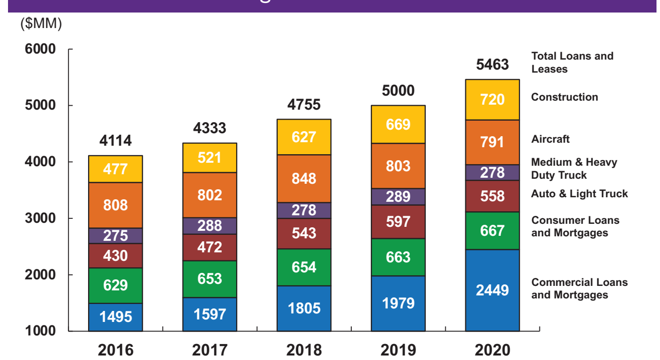
2020 net income was $81.44 million compared to $91.96 million earned in 2019. Diluted net income per common share for 2020 was $3.17, down from $3.57 the previous year.

Return on average total assets was 1.14% compared to 1.41% a year ago. Return on average common shareholders' equity was 9.41% for 2020, compared to 11.50% for 2019. The average common shareholders' equity-to-average assets ratio for 2020 was 12.15% compared to 12.25% last year.

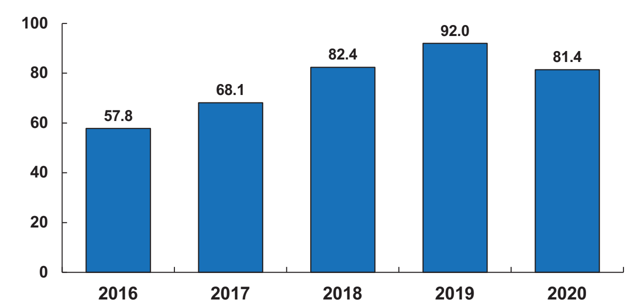
At year-end, total assets were $7.32 billion, up 10.47% from a year earlier. Loans and leases were $5.49 billion, up 7.94%, deposits were $5.95 billion, up 10.99% from 2019 and common shareholders' equity was $886.85 million, an increase of 7.07% from a year earlier.

The allowance for loan and lease losses at year-end was 2.56% of total loans and leases, compared to 2.19% the prior year. The ratio of nonperforming assets to loans and leases was 1.16% for 2020, compared to 0.37% for 2019.

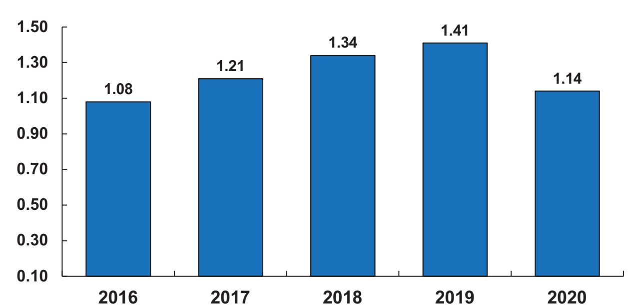
Average Loans and Leases



Net Income *(in millions)*



Return on Average Assets *(as a percent)*



FINANCIAL HIGHLIGHTS

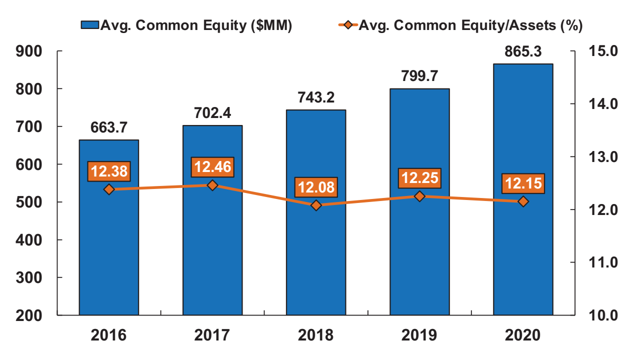
Earnings and Dividends

(Dollars in thousands, except per share amounts)	**2020**	2019	2018	2017	2016
Net interest income	**$ 225,820**	$ 223,866	$ 213,906	$ 185,631	$ 169,659
Provision for credit losses	**36,001**	15,833	19,462	8,980	5,833
Noninterest income	**103,889**	101,130	97,050	98,706	88,945
Noninterest expense	**187,367**	189,009	186,467	173,997	163,645
Net income available to common shareholders	**81,437**	91,960	82,414	68,051	57,786
Common cash dividends	**29,764**	29,021	25,686	20,431	19,416
Per common share					
Diluted net income	**$ 3.17**	$ 3.57	$ 3.16	$ 2.60	$ 2.22
Cash dividends	**1.13**	1.10	0.96	0.76	0.72
Book value	**34.93**	32.47	29.56	27.70	26.00
Return on average common shareholders' equity	**9.41 %**	11.50 %	11.09 %	9.69 %	8.71 %
Return on average assets	**1.14 %**	1.41 %	1.34 %	1.21 %	1.08 %

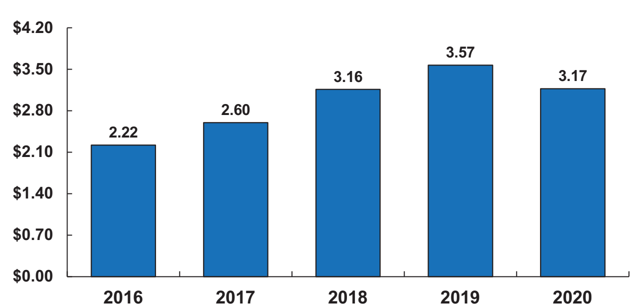
Statement of Condition

Average Balances: *(Dollars in thousands)*					
Assets	**$ 7,120,009**	$ 6,528,274	$ 6,151,439	$ 5,638,322	$ 5,360,685
Earning assets	**6,684,246**	6,104,673	5,761,761	5,251,094	5,003,922
Investments	**1,058,060**	1,014,659	951,812	854,879	812,501
Loans and leases	**5,463,436**	5,000,161	4,755,256	4,333,375	4,113,508
Allowance for loan and lease losses	**130,776**	105,340	99,258	92,187	90,206
Deposits	**5,736,602**	5,276,736	4,963,663	4,493,247	4,302,701
Interest bearing liabilities	**4,546,548**	4,440,905	4,288,617	3,889,169	3,695,309
Shareholders' equity	**865,278**	799,736	743,173	702,419	663,703

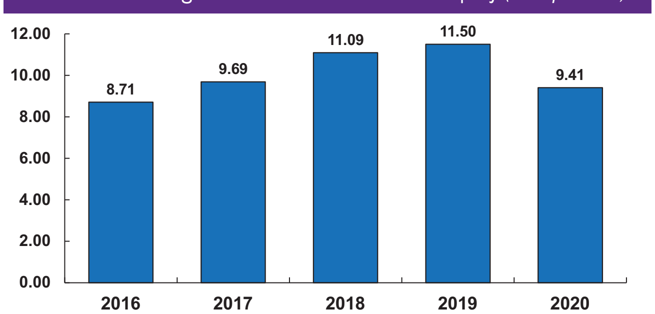
Average Common Shareholders' Equity



Diluted Net Income Per Common Share



Return on Average Common Shareholders' Equity *(as a percent)*



1st Source Corporation

2020 ANNUAL SHAREHOLDERS' LETTER

PRELUDE

Chris Murphy conducting a virtual meeting with members of senior leadership team.

As I open this year's letter there are two items regarding this communication I want to bring to your attention. First, a few years ago we added all the names of our colleagues to the inside cover of this report. This year it is even more important we recognize them, as they are the value of our company! Our first focus once the COVID-19 pandemic hit was keeping them safe so they could deliver on our Mission and serve our clients well. Keeping them safe meant keeping our clients safe as well, which was critically important to us. And the second item is the color of this report. It is out of sequence and not a color we have used before or are likely to use again. Purple seems particularly fitting this year.

To quote Bourn Creative, Color Meaning: "The color purple has a variety of effects on the mind and body, including uplifting spirits, calming the mind and nerves, enhancing the sacred, creating feelings of spirituality, increasing nurturing tendencies and sensitivity, and encouraging imagination and creativity… Dark purple hues evoke feelings of gloom, sadness, and frustration…. Too much purple brings out qualities of irritability, impatience, and arrogance. Too little brings out feelings of powerlessness, negativity, and apathy."

Haven't we felt all the hues of purple this past year? We have learned how much we really need each other. We clearly want something calm; we rely on the sacred, and we have had to be creative in the way we live and work. We have experienced frustration, gloom and sadness, and some of us have even been irritable, impatient and maybe arrogant. Clearly, we have all felt powerless against COVID-19. But imagination and creativity have led to the development of multiple vaccines in record time, and we are going to make it through because of the vaccines and by helping each other. My colleagues were here for each other this year in ways they never have been before to make sure we were here for our clients today and tomorrow.

Normally I focus on the numbers at the start of this letter, and while important, they are not the story this year. This year is about our people, people who care and love being in service to others. It's about leadership in times of stress, it's about our deep values of integrity, teamwork, quality, service, respect and dignity in the personal service we give to our clients and neighbors, and community leadership. I could not be prouder of what everyone here did this year. We stepped up together and followed CDC guidelines, we changed workplaces to lower infection risk, high risk colleagues moved to work remotely supported with new equipment and bandwidth set up by our Information Technology teams, we learned to use video outreach, we provided excellent service even though our banking centers were open by appointment only, we mentored and counselled over 3,500 clients through the Paycheck Protection Program (PPP) application and eventual forgiveness process, we handled tens of thousands of stimulus payments, we processed a record number of home mortgage loans, and we worked with clients having payment problems due to coronavirus shutdowns to defer loan payments until better times. Our people are all heroes in this year of challenge.

I am particularly proud of our leadership team who learned how to work more collaboratively and with greater urgency, and who I believe developed greater respect for each other's capabilities and differing perspectives brought to the day-to-day challenges of COVID-19.

So, as I start my report, I extend a big shout out of THANKS to all my colleagues in 1st Source for their hard and smart work and their dedication.

INTRODUCTION

This year was like none other in my 50 years in banking. We started knowing we would be challenged by tightening margins and a few credit problems as we often are. The Federal Reserve had lowered the Fed Funds rate four times since the last month of 2018, down 100 basis points by the end of 2019, and was on a path to lower them even more in 2020 to keep the economy growing. Rates on loans were decreasing and we were getting to a point where the bank could not lower deposit pricing much more. We outlined plans to hold margins and manage credit and the balance sheet so we could continue to make the necessary investments in people, systems, technology, and facilities that are all part of growing the bank while also cutting in certain areas to hold costs in check and still increase earnings. We planned on some small increases in net income. We came out of a robust and lively two-and-a-half-day off-site strategic planning meeting with our Board in early February with our plans vetted and approved and us already executing. Then COVID-19 hit. We had to pivot!

FOCUS

Our first action was to assemble our pandemic response team and pull our pre-developed plan off the shelf. It gave us a guide, but COVID-19 was not like anything we had planned for. Andrea Short, then our Chief Financial Officer and now also our President, took control of the team and coordinated our actions and reactions. Our first concern was taking steps to make sure the bank could operate in almost any unfolding scenario. Critical functions were identified, split apart and moved so everyone in a unit could not be infected at the same time. Our facilities management team under John Bedient's direction moved dozens of people to new work areas in very short time with little disruption to bank operations. Critical functions that could be operated remotely were identified and equipped to do so. This required the purchase and installation of new hardware and software as well as dramatically increased bandwidth so people could work from home if need be. Kevin Murphy, then head of Information Technology, and his colleagues developed and implemented new processes and controls. Our IT colleagues, working with Dan Lifferth, head of HR, equipped high risk employees to work remotely if their job allowed for such. For the most part, we kept people working in the bank rather than remotely. We believe we work better physically together and had taken a proactive approach to managing employee health to minimize the impact of the pandemic. We felt people were safer at the bank than they would be at home. That proved to be the case as there has been almost no transmission of the virus on bank premises. Almost all transmission has been at home or from activities in the community.

While we did not know what would or could happen nor what the Government's response might be, with the counsel of some of our Board members, we developed a series of scenarios and steps we would require ourselves to take depending on how the pandemic played out. We set up decision parameters using health, economic, and financial metrics to determine whether next steps would need to be taken to ensure continued financial strength and in what priority of execution they were to be taken. The bank's capabilities to serve our clients safely were our primary focus no matter how deep the economic crises. Keeping people safe and employed was just as important so we could serve our clients well throughout the challenge and be strong when the crisis subsided. Those indices are still being used and will continue to guide us as we make decisions over the next year.

PERFORMANCE

With all that went on this year, I could not be happier with our results. We earned well, built our credit reserves, maintained our capital levels and our long-term record of annually increasing dividends. For 2020 net income was $81.4 million, down from $92.0 million the prior year. Earnings per share was $3.17 this year compared to $3.57 the year before. This result was primarily driven by a provision for credit losses of $36.0 million in 2020 compared to $15.8 million in 2019. The increase in the provision is to cover anticipated losses embedded in our portfolios, especially in bus, auto and van rental, hospitality and food service, as well as other small businesses impacted by closures required to fight COVID-19. We were benefited by the income from the Paycheck Protection Program (PPP) loans we provided and the substantially higher volumes of mortgage loan originations and refinancing.

We ended 2020 with strong capital and reserves, as we believe it best to maintain a fortress-like balance sheet so we can withstand the challenges in the economy that seem to be coming with increasing rapidity and so we can help our clients weather them well. At December 31, 2020, our common equity-to-assets ratio was 12.12%, down slightly from 12.51% a year ago. The tangible common equity-to-tangible assets ratio was 11.10% compared to 11.38% a year earlier. The decrease of these ratios was driven more by the increase in PPP loans and stimulus monies than anything else. The common equity tier 1 ratio which takes into account the quality of the assets by their type, calculated under bank regulatory guidelines, was a strong 13.06% at December 31, 2020, compared to 12.55% a year ago. During the year, 166,446 shares were repurchased for treasury reducing common shareholders' equity by $6.4 million. Additionally, during the fourth quarter, we adopted the Current Expected Credit Loss (CECL) accounting standard and recognized a one-time cumulative adjustment reducing retained earnings by $2.6 million, net of deferred taxes, effective January 1, 2020. CECL resulted in a two-to-three basis point reduction to our regulatory capital ratios as of December 31, 2020.

The detail of all these numbers is found in the Form 10-K within this annual report, which is also filed with the SEC and available on our website, so I will not go into them any further here.

Bank and community leaders celebrating ribbon cutting of new banking center in Auburn, Indiana.

Perhaps the greatest challenge in 2020 was managing credit issues. Our credit team, under the direction of Jeff Buhr, our Chief Credit Officer, immediately came together to work with our relationship managers to provide relief to our clients so they could work their way through the pandemic. This led to significant communication at the outset with each client likely to be negatively impacted. Our team worked hard to understand each situation and then to craft a solution unique to each business.

We knew credit was going to be a problem and this became even more evident as the pandemic spread across the country and various governors took actions to close down their states and have people stay in their homes. Our credit team immediately focused on loan deferrals, either principal and interest or principal alone. Hospitality, tourism, non-grocery food service, and a host of personal service businesses were deeply impacted. With a loan portfolio of $5.1 billion going into the pandemic, we provided deferrals for a total of approximately $1 billion in loans as the year wore on. These deferrals were generally for anywhere from one month to six months and at the close of 2020, we had only approximately $170 million still on deferral. Emphasis was placed on our national specialty finance customers, many of whom were dependent on tourism, entertainment, sports or travel in general. Chris Craft, President of the Specialty Finance Group, worked with his team in cooperation with Jeff and the credit department to contact, counsel, monitor and assist clients as they dealt with ever increasing problems.

In late March, the Government introduced its Paycheck Protection Program (PPP) which saved many businesses and helped all who received it. Larry Mayers, SVP and head of Business Banking, and Ryan Bell, AVP and head of our Small Business Administration (SBA) unit, led the effort to ensure that the relationship managers in our community banks and in our specialty finance units could develop, submit, upload, and secure PPP forgivable loans from the SBA. The credit department played a significant role in this as did our information technology and loan operations folks. We were aggressive in having our bankers reach out to serve the needs of our markets and eventually provided $597.5 million in PPP loans to 3,540 small businesses including sole proprietors. By the close of the year, $236.2 million in loans to 1,672 clients had been forgiven. This saved many and kept good people in our markets and among our clients employed!

As mentioned above, at the end of 2020 we adopted the Current Expected Credit Loss (CECL) methodology for calculating the allowance for credit losses. This resulted in a four basis-point increase to the allowance for loan and lease losses at December 31, 2020, to 2.56% of total loans and leases compared to 2.19% at December 31, 2019. The allowance calculation includes the PPP loans guaranteed by the SBA. Excluding those loans from the calculation results in an allowance of 2.73% at December 31, 2020 compared to 2.19% at December 31, 2019.

Net charge-offs for the year were $9.2 million compared to net charge-offs of $5.1 million in 2019. This resulted in a charge-off ratio of 0.17% for 2020, compared to 0.10% for 2019. The majority of the 2020 net charge-offs were related to one relationship within the construction equipment portfolio and numerous bus relationships in the auto and light truck portfolio that have been severely impacted by the pandemic shut down of events and tourism.

As I mentioned above, the provision for credit losses was $36.0 million for the twelve months ended December 31, 2020, an increase of $20.2 million over the prior year due to the impact of COVID-19, among other things. The ratio of nonperforming assets to loans and leases was 1.16% as of December 31, 2020, compared to 0.37% on December 31, 2019. Excluding PPP loans, the ratio of nonperforming assets to loans and leases was 1.24% at December 31, 2020.

Messaging throughout the community showcasing our support of small business through the Paycheck Protection Program.

GROWTH

We still believe that the client is best served with personal convenience and advice, a caring and responsive attitude, easy to use technology, and by people he or she can trust as they are local and truly neighbors. So, we continue to invest in our banking centers as that is where we meet our clients for their convenience. We started 2020 by opening new facilities in Middlebury and Auburn, Indiana, extending our reach for new customers and providing more convenience for present clients. And during the pandemic, while we went to by-appointment-only to keep our colleagues and clients safe, we accelerated our drive-up teller lane staffing and capabilities. We also became more active, reaching out through video conferencing to engage and help clients. This outreach was true in all areas of the bank and became essential in wealth management as the equity and fixed income markets dropped dramatically in response to fears over the pandemic's impact. Our investment managers, asset advisors, and our trust administrators in Wealth Advisory Services, under Chris Strafford's leadership, became proactive in counseling clients to take a long-term view and not make abrupt changes in their portfolios. Paul Gifford, Chief Investment Officer in Wealth Advisory Services, began publishing our views on the market more often and offered video conferences to discuss the movements and expectations in and for the market. This all proved to be fortuitous, and his advice spot on, as the markets quickly regained their losses and the wealth of many clients was restored.

PEOPLE AND CHANGE

2020 was not only challenging on its own, but it added extra stress to a number of leadership changes that were announced in June. Jim Seitz, who had been President of the Bank since 2012 and a manager/officer since joining the bank in 1980, decided to give up his 80-hour work week here and spend more time with his growing family of children and grandchildren. He agreed to stay on until the next Annual Meeting as Vice Chairman of the Bank Board to help transition Andrea Short, our new President and CFO, into her new responsibilities. Jim agreed to serve a little longer because of his love for the bank and our colleagues, and so our fellow board members could benefit from his long history and experience here.

Andrea has been CFO since 2013 and before that served successively and successfully as Tax Director, Controller and Chief Accounting Officer. She joined the bank in 1998 and has demonstrated many times her commitment to our values, her expertise and her selfless leadership. While we will miss Jim, we welcome Andrea as a partner in her new position. She continues to have the financial and operating units of the bank reporting to her and has added the core client-facing units as well. Our Commercial Banking, Community Banking, and Specialty Finance units now report to her as they did Jim.

With Andrea's ascendency, Ron Zeltwanger, head of the Community Banking Group, has taken direct responsibility for serving our consumer and small business loan and deposit needs through our banking centers. Ron has all the Regional Presidents reporting to him as well as our consumer lending personnel.

Larry Mayers, Regional President of our Fort Wayne Region, has also taken responsibility for driving our Business Banking Group, focusing on the needs of our larger business clients. Larry added Treasury Services, SBA, Retirement Planning Services and Solar Financing to his portfolio of responsibilities.

We used these changes as an opportunity to bring our Central Region, which encompasses north central Indiana and southwestern Michigan, into a formal consolidated region with its own President. Shelli Alexander has taken on that role and brings to it a strong background in business banking, entrepreneurial activity and leadership talent. Prior to joining 1st Source as a Central Region business banker in 2012, she had 18 years in business banking and a few years as a business owner. She has already demonstrated her leadership capabilities by helping start and grow our Solar Financing business. She has shown herself to be an effective, client focused, and caring leader who prepares herself well for any new responsibilities she takes on.

As an additional step in the realignment, to give Andrea time to learn and master her new responsibilities, and to bring fresh eyes to one of our businesses, John Griffith, Chief Administrative Officer, has taken on additional responsibility for our Wealth Advisory Services Group (WAS) headed by Chris Strafford. John's legal and accounting/finance background should fit well with the long-term needs of WAS and its clients.

We have also recognized the growing need for a focus of digital delivery, digital workflow, and data management and analysis to improve the way we serve clients. Technology has become ever more important, and all those units using technology to serve clients need to be assured that we are making the proper investments and using the data produced by our clients to better serve them. Kevin Murphy, who joined the bank in 2006 and had previously served as Central Region President and most recently as head of Information Technology, was promoted to Group Head of a newly constituted Information Technology, Marketing and Digital Strategy unit. In this position, he oversees our virtual bank, which he previously led, information technology, marketing and our customer relationship management platform.

All of these promotions and appointments are part of our strategic effort to provide strong leadership to 1st Source for years to come. We continue to build for smooth transitions of responsibility and authority among a larger group of 1st Source team leaders assuring continued performance into the future.

Donations made by various Bank departments to Goshen Health's emergency department.

If there was ever a year that called for communication and leadership, this was it. Whether it was the COVID-19 pandemic, racial unrest, or political divisiveness leading to violence, there were any number of occasions that called for a response. We worked hard to reinforce our values inside the bank and spoke out in some cases outside the bank if we felt it would be helpful. We take our responsibility to our communities very seriously, and we believe we needed to help where we could. This took many forms in direct comment, financial support and volunteer activity. One of our values is to be in leadership of the communities we serve, making them better places to live, work, worship, raise families and build businesses. And we tried to do just that in 2020.

Just making sure both our clients and our colleagues knew we were here for them and were trying to make decisions that would assure our continued service to them was challenging at best. We communicated to colleagues, clients and the community on video, TV, email and op-ed pieces pointing out the things we were doing to keep our facilities safe and encouraging adherence to the CDC protocols.

In internal communication, we were honest that this was going to go on for some time, well into the summer of 2021 and maybe beyond. We stated our goal was to make sure the bank remained safe and sound, to keep our employment base as stable as long as we could by modulating employment levels through attrition and retirements. We instituted a hiring freeze and reduced costs by eliminating all non-essential spending including travel and entertainment. We committed to preserving pay and benefits including contributions to our retirement programs as long as possible and to continuing our record of annually increasing our dividend for our shareholders. We communicated through virtual All Officer meetings and an all employee Town Hall to assuage fears, answer questions, and encourage strong client outreach and service.

Our sister organization, 1st Source Foundation, stepped up and made $600,000 available to community organizations in our markets that were serving those most impacted by the coronavirus. This was done by funding local United Way organizations in each community we serve, believing they were the best equipped to determine who should receive our funds. That was followed by a contribution late in the year of $320,000 to healthcare networks and facilities across northern Indiana and southwestern Michigan to thank frontline health care workers most exposed to COVID-19 for their tireless and sacrificial commitment to the safety of our communities. The Foundation also provided additional grants to help many other not-for-profit organizations negatively impacted by COVID-19 that are so important to the richness of the communities in which all our clients and colleagues live. And lastly, our team of colleagues, in spite of being "sheltered in place" volunteered over 12,000 hours of service to all the organizations that make up the fabric of our communities, assuring a safety net of social services, community development, good health care, opportunities for spiritual development, education, and the visual and performing arts.

In June, the tragic events leading to the death of George Floyd caused us all to step back and think about the divisions and problems in our society. We stepped out both internally and externally reinforcing one of 1st Source's core values. We have always believed in the dignity of every human being and that all people should be treated with deep respect and that we are here to serve. Our Mission is to help our clients achieve security, build wealth and realize their dreams, and that means we try as best we can with everyone. But the pain and turmoil running through our communities and others across the country should cause us to stop and ask: "are we doing enough?" Of course, as a society we are not, otherwise these kinds of events, the senseless loss of life, would not occur. While we, at 1st Source, have always stood for a greater care for people, these events caused us to pause to listen better, to learn better, and to understand better. We are all invited, actually required, by these events to elevate our community spirit and leadership by thoughtful caring for those around us who might bear some unknown or unseen burdens and reinforce a gentleness to all.

We also communicated internally after the recent events in Washington D.C. reinforcing again the values embedded in 1st Source. We believe in the dignity of each person, we believe in listening to each other to learn, to understand, to work better together. We may disagree, but we listen. Our communities and the bank thrive when we work together, when we believe that we all want the same thing: freedom, justice, a fair shot at living in a community of mutual respect, where each of us can be assured of fair and equal treatment, raise our families, find meaningful and satisfying work, worship as we believe, build businesses, and have meaningful and rich lives. At 1st Source, we should all work to make that a reality for all in the communities we serve. And we do that by stepping back, relearning how to talk with each other, to learn from and understand each other, to find common ground to build supportive relationships and get back to building our communities and this country for our children and theirs for generations to come, just as we have been trying to do since 1863.

Our Board has played an active role in advice and counsel as we moved through the year dealing with the challenges I have written about above. They were always there for help and direction as we needed it. The year did see some changes that are important to note. As mentioned above, in June, Jim Seitz retired as President and became Vice Chairman of the Bank Board. Rex Martin, a long-time trusted and talented member of the Board and our Executive Committees, the owner and leader of a multi-generation family business in our community with national and international markets, decided to retire from the Board due to a series of changes in his personal and business life. We recognized his valuable service and his long commitment to the bank's success with a unanimous proclamation by the Board extolling his contributions. We want to reinforce that gratitude here. We will miss him.

In July we welcomed a new board member who has also run a complex multi-generation family business which has gone through significant transformation. Todd Schurz is the President and Chief Executive Officer of Schurz Communications, Inc., a privately-owned diversified communications company with a series of broadband and cloud services companies nationally and internationally. He and the companies he has worked for and run have been in the newspaper, television, radio, and cable businesses across the country and have now pivoted to the digital side. Todd is well respected in our local business community and, like Rex before him, has held leadership positions in not-for-profit and economic development organizations in the communities we serve. His leadership skills, his long and broad business experience, and his understanding of communications and digital technologies are a welcome addition to our Board.

In closing, I want to thank and again recognize my leadership colleagues in 1st Source and all of our teammates across the company who have stepped up and performed admirably in this unprecedented year of challenge. I could not be more thankful for them and their commitment to serving our clients and each other. I am blessed to work with people who love being in service to others. And I want to thank our Board for their wise counsel and support as we addressed the challenges presented to us this year. We look forward to continuing to build 1st Source together. And lastly, thank you to our shareholders. We promise to work hard to continue to earn your investment in us.

Yours,

Andrea Short recording a video address for the virtual THRIVE Engaging Women Conference hosted by Saint Mary's College.

SERVICES

PERSONAL

Checking

Savings
Certificates of Deposit
IRAs
Health Savings Accounts

Loans
Personal
Automobile
Home Equity
Mortgage
Boat, RV, Motorcycle

Asset Management

Trust and Estate Administration
Trust Administration
IRA/401(k) Management
Special Needs Trust
Estate Settlement
Bill Payment Services
Charitable Trust & Foundation Administration

Wealth Advisory Services
Investment Management
Estate Planning
Charitable Strategies
Retirement Planning
Education Planning
Tax Planning
Insurance Solutions

Private Banking
Relationship Management
Premier Convenience in Day-to-Day Banking
Deposit/Treasury Services Specialization
Mortgage Loans
Lines of Credit (secured and unsecured)
Checking

BUSINESS

Loans & Leasing
Treasury Services
Merchant Card Services
Business 401(k) Plans
Retirement Plan Services

SPECIALTY EQUIPMENT FINANCE

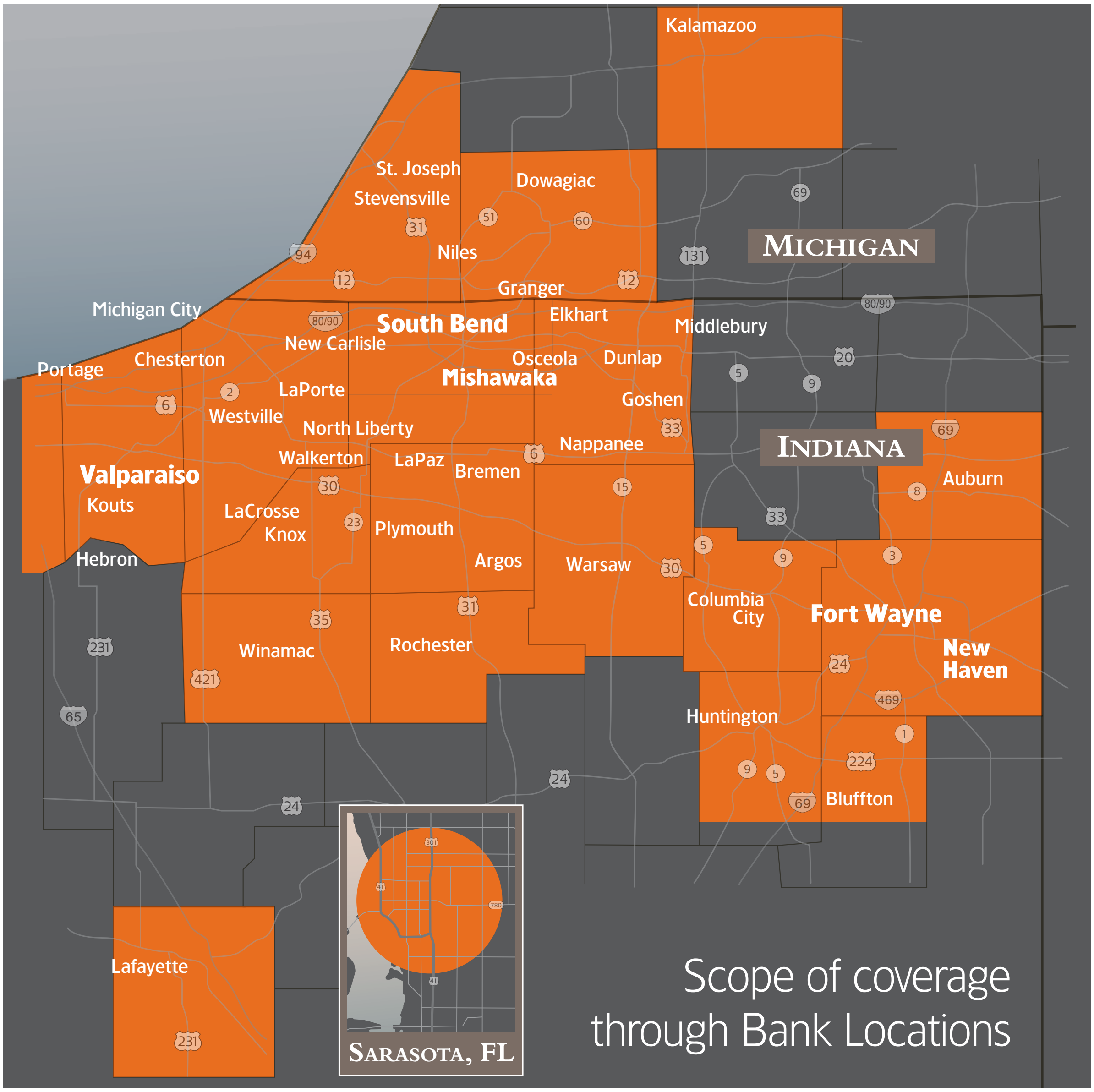
Aircraft & Helicopter
Auto & Light Truck
Medium & Heavy Duty Trucks
Construction Equipment
Shuttle Bus
Step Vans
Funeral Cars
Motor Coaches

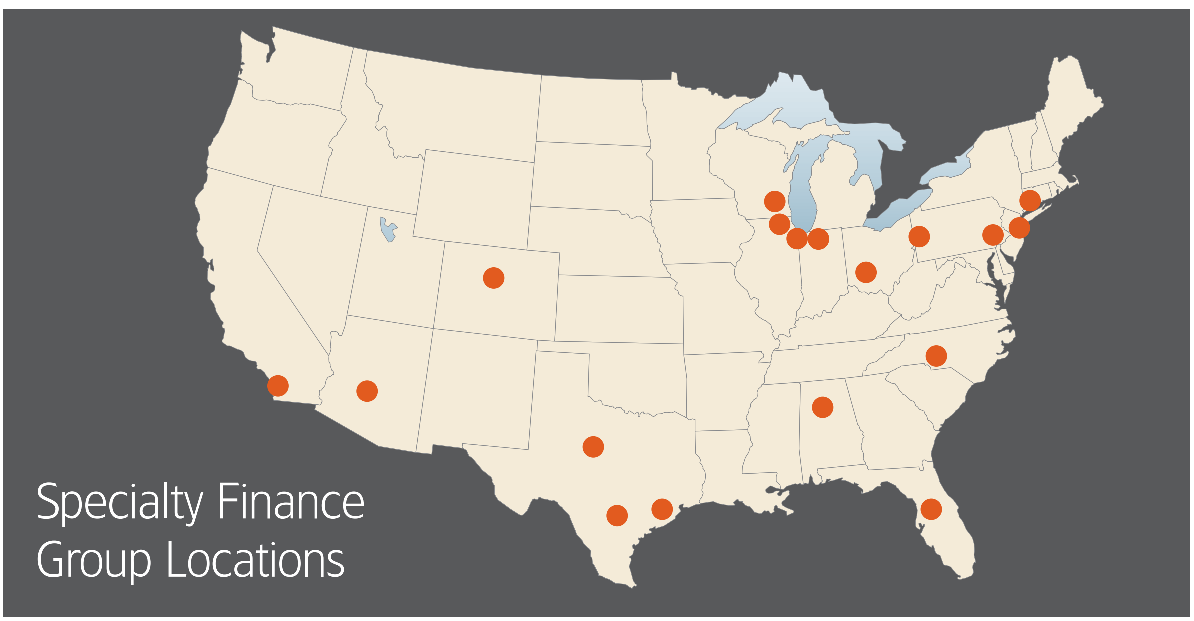
INSURANCE

Personal
- Homeowners
- Rental
- Flood
- Umbrella Liability Coverage
- Life & Health
- Disability Income
- Automobile
- Snowmobile
- Recreational Vehicle
- Boat

Business
- Commercial Auto
- Commercial Property
- Crime
- Employment Practices
- Key Man Life
- Environmental Liability
- General Liability
- Umbrella/Excess Liability
- Workers' Compensation
- Crop Insurance

LOCATIONS


Kalamazoo
St. Joseph
Stevensville
Dowagiac
Niles
Granger
Michigan City
South Bend
Elkhart
Middlebury
New Carlisle
Portage
Chesterton
Osceola
Dunlap
Mishawaka
LaPorte
Goshen
Westville
North Liberty
Nappanee
Walkerton
LaPaz
Bremen
Valparaiso
Auburn
Kouts
LaCrosse
Knox
Plymouth
Hebron
Argos
Warsaw
Columbia City
Fort Wayne
New Haven
Winamac
Rochester
Huntington
Bluffton
Lafayette
MICHIGAN
INDIANA
SARASOTA, FL
Scope of coverage through Bank Locations


Specialty Finance Group Locations

SHAREHOLDERS' INFORMATION

2020 STOCK PERFORMANCE & DIVIDENDS

1st Source Corporation common stock is traded on the Over-The-Counter Market and is listed on the NASDAQ Global Select Market under the symbol "SRCE." 1st Source is also listed on the National Market System tables in many daily papers under the symbol "1stSrc."

High and low common stock prices, cash dividends paid for 2020 and book value were:

Quarter Ended	High	Low	Cash Dividends Paid
March 31	$ 52.16	$ 26.07	$ 0.29
June 30	38.70	26.72	0.28
September 30	38.26	28.72	0.28
December 31	41.10	30.33	0.28

Book value per common share at December 31, 2020: $34.93

ANNUAL MEETING OF SHAREHOLDERS

The virtual Annual Meeting of Shareholders has been called for 10:00 a.m. EDT, April 22, 2021, at www.virtualshareholdermeeting.com/SRCE2021.

Access to the annual meeting is limited to shareholders only and a control number is required to log in. If your shares are held in "street name" (that is, through a broker), you can gain access to the meeting by logging into you brokerage firm's website to link through to the meeting.

COMMON STOCK LISTING

The NASDAQ Global Select Market
Market Symbol: "SRCE"
CUSIP #336901 10 3

1stsource.com

For the latest shareholder information, log on to www.1stsource.com.
Click on the "About Us" link and then "Investor Relations."

If you would like to receive email alerts, please sign up on our website.

TRANSFER AGENT, REGISTRAR AND DIVIDEND DISBURSING AGENT

American Stock Transfer and Trust Company
6201 15th Avenue
Brooklyn, NY 11219
(800) 937-5449

INDEPENDENT AUDITORS

BKD, LLP
200 East Main Street
Suite 700
Fort Wayne, IN 46802

SHAREHOLDER INQUIRIES

1st Source Corporation
Andrea G. Short,
Chief Financial Officer
Post Office Box 1602
South Bend, IN 46634
(574) 235-2000
shareholder@1stsource.com

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2020

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

1st Source Corporation
(Exact name of registrant as specified in its charter)

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

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock — without par value	SRCE	The NASDAQ Stock Market LLC

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

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report ☒

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2020 was $695,302,047

The number of shares outstanding of each of the registrant's classes of stock as of February 12, 2021: Common Stock, without par value — 25,301,678 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 2021 Proxy Statement for the 2021 annual meeting of shareholders to be held April 22, 2021, are incorporated by reference into Part III.

TABLE OF CONTENTS

Part I

Item 1. Business.

1ST SOURCE CORPORATION

1st Source Corporation, an Indiana corporation incorporated in 1971, is a bank holding company headquartered in South Bend, Indiana that provides, through its subsidiaries (collectively referred to as "1st Source", "we", and "our"), a broad array of financial products and services. 1st Source Bank ("Bank"), its banking subsidiary, offers commercial and consumer banking services, trust and wealth advisory services, and insurance to individual and business clients through most of our 79 banking center locations in 18 counties in Indiana and Michigan and Sarasota County in Florida. 1st Source Bank's Specialty Finance Group, with 18 locations nationwide, offers specialized financing services for construction equipment, new and used private and cargo aircraft, and various vehicle types (cars, trucks, vans) for fleet purposes. While our lending portfolio is concentrated in certain equipment types, we serve a diverse client base. We are not dependent upon any single industry or client. At December 31, 2020, we had consolidated total assets of $7.32 billion, total loans and leases of $5.49 billion, total deposits of $5.95 billion, and total shareholders' equity of $886.85 million.

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

1ST SOURCE BANK

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

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

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

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

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

Construction equipment financing includes financing of equipment (i.e., asphalt and concrete plants, bulldozers, excavators, cranes and loaders, etc.) to the construction industry. Construction equipment finance receivables generally range from $50,000 to $25 million with fixed or variable interest rates and terms of one to ten years.

Aircraft financing consists of financings for new and used general aviation aircraft (including helicopters) for private and corporate aircraft users, aircraft distributors and dealers, air charter operators, air cargo carriers, and other aircraft operators. For many years, on a limited and selective basis, 1st Source Bank has provided international aircraft financing, primarily in Mexico and Brazil. Aircraft finance receivables generally range from $500,000 to $15 million with fixed or variable interest rates and terms of one to ten years.

The auto and light truck division (including specialty vehicles such as step vans, vocational work trucks, motor coaches, shuttle buses and funeral cars) consists of fleet financings to automobile and light truck rental companies, commercial leasing companies, and single unit to fleet financing for users of specialty vehicles. The auto and light truck finance receivables generally range from $50,000 to $30 million with fixed or variable interest rates and terms of one to eight years.

The medium and heavy duty truck division provides fleet financing for highway tractors, medium duty trucks (including environmental vehicles) and trailers to the commercial trucking industry. Medium and heavy duty truck finance receivables generally range from $50,000 to $20 million with fixed or variable interest rates and terms of two to seven years.

In addition to loan and lease financings during 2020, the group had average total deposit account balances of approximately $219 million.

SPECIALTY FINANCE GROUP SUBSIDIARIES

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

1ST SOURCE INSURANCE, INC.

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

CONSOLIDATED VARIABLE INTEREST SUBSIDIARIES

1st Source Bank is the managing general partner in the following subsidiaries that have interests in tax-advantaged investments with third parties: 1st Source Solar 2, LLC, 1st Source Solar 3, LLC, 1st Source Solar 4, LLC, 1st Source Solar 5, LLC and 1st Source Solar 6, LLC.

OTHER CONSOLIDATED SUBSIDIARIES

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

1ST SOURCE MASTER TRUST

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

COMPETITION

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

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

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

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

HUMAN TALENT

Our primary objective for personal development and personnel management is to attract, retain and develop the highest quality people. To support this objective, our human resource programs are designed to develop colleagues and prepare them for appreciating and pursuing lifelong learning, properly serving our clients, critical roles and leadership positions for the future; reward and support them through competitive pay and benefit programs; enhance the Company's culture and values through efforts aimed at making the workplace more diverse and inclusive; and attract people and facilitate internal development and mobility to create a high-performing, diverse group of colleagues.

We are concerned with the health and safety of our colleagues, clients and the communities we serve. The COVID-19 pandemic has created challenges that required an immediate and evolving response to ensure the safety of our team members and our clients. See Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Coronavirus (COVID-19) Impact" for more information regarding the actions we have taken in response to the ongoing pandemic.

One of our foundational values is community leadership. We encourage our team members and leaders to support the organizations and causes they are passionate about, and to serve their communities in the ways they are able. The pandemic has had an impact on volunteer opportunities and events that bring people together in support of those in need. We are pleased that this did not stop our colleagues from doing what they could, when and how they could. During 2020, our team members volunteered over 12,000 hours of their time to such causes.

At December 31, 2020, we had approximately 1,175 colleagues on a full-time equivalent basis.

ENVIRONMENTAL SUSTAINABILITY

1st Source endeavors to be a good steward of the environment. We have an approach that protects and conserves our natural resources through methods such as:

Developing business practices that protect and conserve natural resources — We use responsible, reputable, and monitored e-recyclers for our electronic assets. All computers, including desktops, laptops, and monitors, are properly recycled.

We are conscious of our paper usage, recognizing that we depend on printed materials for important day-to-day office work, client communications, and acquiring new clients. Increasingly, consumers demand more environmentally sustainable options and prefer online statements and correspondence rather that printed materials. The majority of the paper used in our facilities is recycled through our secure shred program and in 2020 we recycled 251,000 pounds of paper. In recent years, we have transitioned away from the traditional proxy model and have utilized the notice and access or "e-proxy" model for supplying shareholder materials for our Annual Meeting. This has resulted in a reduction in the amount of paper consumed by us each year during this process. We have also utilized recycled paper for the production of shareholder materials which we are required to print upon shareholder request. The paper we use for the production of shareholder materials is also certified by the Forest Stewardship Council (FSC). The FSC promotes environmentally appropriate, socially beneficial, and economically viable management of the world's forests.

Additionally, we are utilizing various sustainable practices in some of our facilities such as LED lights, daylight harvesting sensors, programmable thermostats, 95% or higher efficiency furnace systems, drip irrigation, 90% recycled mats, sustainable landscaping and smart irrigation systems. In an effort to reduce our carbon footprint, we have utilized solar panels in two of our banking centers for supplemental sustainable power. These banking centers have supplemented approximately 23% of their total electrical usage (per banking center) with renewable solar power.

Embracing opportunities for new products, services and partnerships — In 2020, we continued our focus on renewable energy sources through lending and investment partnerships with renewable energy providers. We recognize the opportunities and complexities associated with energy financing and understand the value of innovative technology that leverages the wind and sun, which are sustainable from an environmental and financial perspective. To date, we have invested $84 million and provided debt financing in 32 solar projects across 12 states with current loan and lease outstandings of $293 million. We employ a values-based, relationship-focused approach to financing solar projects and partner with strong developers who have national project pipelines.

Many of our solar clients focus on projects in Midwestern and Northeastern states. This geographic focus is driven primarily by new and developing state solar programs, many of which require or include incentives for Community Solar projects, which are distributed generation solar projects but are typically smaller in size than small utility projects. These solar projects consist of one or multiple solar arrays that are interconnected with the local utility grid. A group of subscribers, including commercial businesses, small business, municipalities, and residential homes, participate in the program and receive the benefits of purchasing their electricity from the community solar array. Community Solar projects are a strategic focus for our portfolio, with existing community solar projects in Minnesota, Illinois, New York, and Massachusetts. In addition to our focus on Community Solar projects, we also finance solar projects that provide clean energy to colleges, universities, school districts, utilities, and municipalities as we seek to continue our efforts to reduce our carbon footprint through sustainable investments.

The 32 solar projects in our existing portfolio have a current operating capacity of 288,852 MWh per year, which is equivalent to avoiding 204,230 metric tons of carbon greenhouse emissions or 225 million pounds of coal burned. We are committed to investing in and financing solar energy projects and are pleased with the current and ongoing environmental benefits of this portfolio that positively impact the lives of people in communities across the United States. We will continue to finance and invest in sustainable opportunities, and we will explore new opportunities to develop products and solutions that support our clients and advance sustainability.

Adopting new technologies — We encourage our clients to take advantage of our online and mobile banking tools. Our ATM devices allow clients to make deposits without the need for an envelope. This reduces the use of paper, which again reduces emissions throughout our supply chain.

To help reduce emissions associated with travel, we have tools that help clients choose the banking center and ATMs closest to them. In addition, mobile deposit features are available to our clients, enabling them to deposit checks into their accounts using their mobile devices.

Many of these approaches can create long-term value for our clients and shareholders through increased revenues, reduced costs and improved convenience.

REGULATION AND SUPERVISION

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

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

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

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

Capital Standards — The federal bank regulatory agencies use capital adequacy guidelines in their examination and regulation of bank holding companies and banks. If capital falls below the minimum levels established by these guidelines, a bank holding company or bank must submit an acceptable plan for achieving compliance with the capital guidelines and, until its capital sufficiently improves, will be subject to denial of applications and appropriate supervisory enforcement actions. For banks, the FDIC's prompt corrective action regulations establish five capital levels for financial institutions ("well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized"), and impose mandatory regulatory scrutiny and limitations on institutions that are less than adequately capitalized. At December 31, 2020, the Bank was categorized as "well capitalized," meaning that our total risk-based capital ratio exceeded 10.00%, our Tier 1 risk-based capital ratio exceeded 8.00%, our common equity Tier 1 risk-based capital ratio exceeded 6.50%, our leverage ratio exceeded 5.00%, and we are not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure. The various regulatory capital requirements that we are subject to are disclosed in Part II, Item 8, Financial Statements and Supplementary Data — Note 20 of the Notes to Consolidated Financial Statements.

As of December 31, 2020, we were in compliance with all applicable regulatory capital requirements and guidelines.

In September 2019, the Federal Reserve and other federal banking agencies adopted a final rule, effective January 1, 2020, creating a community bank leverage ratio ("CBLR") for institutions with total consolidated assets of less than $10 billion and that meet other qualifying criteria. The CBLR provides for a simple measure of capital adequacy for qualifying institutions. Qualifying institutions that elect to use the CBLR framework and that maintain a leverage ratio of greater than 9% will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the regulatory agencies' capital rules and to have met the well-capitalized ratio requirements. Management reviewed the CBLR framework and has determined that 1st Source and the Bank will not elect to use the CBLR framework.

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

Gramm-Leach-Bliley Act of 1999 — The GLBA expanded the types of financial activities a bank may conduct through a financial subsidiary and established a distinct type of bank holding company, known as a financial holding company, which may engage in an expanded list of activities that are "financial in nature." These activities include securities and insurance brokerage, securities underwriting, insurance underwriting, and merchant banking. We do not currently intend to file notice with the Federal Reserve to become a financial holding company or to engage in expanded financial activities through a financial subsidiary of the Bank.

Financial Privacy — The GLBA also includes privacy protections for nonpublic personal information held by financial institutions regarding their customers. In accordance with the GLBA, Federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about customers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy provisions of the GLBA affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. We are also subject to various state laws, including the recently enacted California Consumer Privacy Act, that generally require us (directly or indirectly through our vendors) to protect the personal information of individual customers and notify them if confidentiality of their personal information is or may have been compromised as the result of a data security breach or failure.

USA Patriot Act of 2001 — The USA Patriot Act of 2001 (USA Patriot Act) substantially broadened the scope of anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations on financial institutions. The regulations adopted by the Treasury under the USA Patriot Act require financial institutions to maintain appropriate controls to combat money laundering activities, perform due diligence of private banking and correspondent accounts, establish standards for verifying customer identity, and provide records related to suspected anti-money laundering activities upon request from federal authorities. A financial institution's failure to comply with these regulations could result in fines or sanctions, including restrictions on conducting acquisitions or establishing new branches, and could also have other serious legal and reputational consequences for the institution. We have established policies, procedures and systems designed to comply with these regulations.

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

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

The Bank is also subject to numerous restrictions imposed by the Federal Reserve Act on extensions of credit to insiders of 1st Source and/or the Bank – executive officers, directors, principal shareholders, or any related interest of such persons.

Reserve Requirements — The Federal Reserve requires all depository institutions to maintain reserves against their transaction account deposits. For all net transaction accounts in 2021, the reserve requirement ratio was set to zero percent in March 2020; therefore, all net transaction accounts are exempt from reserve requirements.

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

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

Sarbanes-Oxley Act of 2002 — The Sarbanes-Oxley Act of 2002 (SOA) includes provisions intended to enhance corporate responsibility and protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws, and which increase penalties for accounting and auditing improprieties at public traded companies. The SOA generally applies to all companies, including 1st Source, that file or are required to file periodic reports with the SEC under the Exchange Act.

Among other things, the SOA also addresses functions and responsibilities of audit committees of public companies. The statute, by mandating certain stock exchange listing rules, makes the audit committee directly responsible for the appointment, compensation, and oversight of the work of the company's outside auditor, and requires the auditor to report directly to the audit committee. The SOA authorizes each audit committee to engage independent counsel and other advisors, and requires a public company to provide the appropriate funding, as determined by its audit committee, to pay the company's auditors and any advisors that its audit committee retains.

Consumer Financial Protection Laws — The Bank is subject to numerous federal and state consumer financial protection laws and regulations that extensively govern its transactions with consumers. These laws include, but are not limited to, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, and the Service Members Civil Relief Act. The Bank must also comply with applicable state usury and other credit and deposit related laws and regulations and other laws and regulations prohibiting unfair, deceptive and abusive acts and practices. These laws and regulations, among other things, require disclosures of the cost of credit and the terms of deposit accounts, prohibit discrimination in credit transactions, regulate the use of credit report information, restrict the Bank's ability to raise interest rates and subject the Bank to substantial regulatory oversight. Violations of these laws may expose us to liability from potential lawsuits brought by affected customers. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce these consumer financial protection laws, in which case we may be subject to regulatory sanctions, civil money penalties, and customer rescission rights. Failure to comply with these laws may also cause the Federal Reserve or DFI to deny approval of any applications we may file to engage in merger and acquisition transactions with other financial institutions or open a new banking center.

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

The Dodd-Frank Act also establishes the CFPB as an independent entity within the Federal Reserve, and the Act transferred to the CFPB primary responsibility for administering substantially all of the consumer compliance protection laws formerly administered by other federal agencies. The Dodd-Frank Act also authorizes the CFPB to promulgate consumer protection regulations that will apply to all entities, including banks, that offer consumer financial services or products. It also includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards, and pre-payment penalties.

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

The Volcker Rule — The Dodd-Frank Act prohibits banks and their affiliates from engaging in proprietary trading and from investing and sponsoring hedge funds and private equity funds. The provision of the statute imposing these restrictions is commonly called the "Volcker Rule." The regulations implementing the Volcker Rule exempt the Bank, as a bank with less than $10 billion in total consolidated assets that does not engage in any covered activities other than trading in certain government, agency, state or municipal obligations, from any significant compliance obligations under the Volcker Rule.

2018 Regulatory Reform — In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (Regulatory Relief Act), was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Act. While the Regulatory Relief Act maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than $10 billion and for large banks with assets of more than $50 billion.

The Regulatory Relief Act, among other things, expands the definition of qualified mortgages a financial institution may hold and simplifies the regulatory capital rules for financial institutions and their holding companies with total consolidated assets of less than $10 billion by instructing the federal banking regulators to establish a single "community bank leverage ratio" of between 8% and 10%. Any qualifying depository institution or its holding company that exceeds this community bank leverage ratio will be considered to have met generally applicable leverage and risk-based capital requirements. Further, any qualifying depository institution that exceeds the new ratio will be considered to be "well capitalized" for purposes of the prompt corrective action rules. In addition, the Regulatory Relief Act includes regulatory relief for community banks regarding regulatory examination cycles, call reports, the proprietary trading prohibitions in the Volcker Rule, mortgage disclosures, and risk weights for certain high-risk commercial real estate loans.

It is difficult at this time to predict when or how any new standards under the Regulatory Relief Act will ultimately be applied to the Bank or 1st Source or what specific impact the Regulatory Relief Act and the yet-to-be-written implementing rules and regulations will have on the Bank or 1st Source.

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

Item 1A. Risk Factors.

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

Credit Risks

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

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

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

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

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

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

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

Our construction and transportation related businesses could be adversely affected by slowdowns in the economy. Clients who rely on the use of assets financed through the Specialty Finance Group to produce income could be negatively affected, and we could experience substantial loan and lease losses. By the nature of the businesses these clients operate in, we could be adversely affected by rapid increases or decreases in fuel costs, terrorist and other potential attacks, and other destabilizing events. These factors could contribute to the deterioration of the quality of our loan and lease portfolio, as they could have a negative impact on the travel and transportation sensitive businesses for which our specialty finance businesses provide financing.

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

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

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

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

<u>**Market Risks**</u>

We may be adversely affected by the world-wide coronavirus (COVID-19) pandemic.

The coronavirus (COVID-19) outbreak has had an adverse impact on certain of our customers directly or indirectly. Entire industries within our loan and lease portfolio such as buses, auto rental and hotels have been impacted due to reduced demand related to quarantines and travel restrictions. Other industries within our loan and lease portfolio or the communities we serve are likely to experience similar disruptions and economic hardships as the current coronavirus pandemic persists. In addition, such events affect the stability of our deposit base, lead to mass layoffs and furloughs which could impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, result in lost revenue or cause us to incur additional expenses.

Additionally, the Federal Reserve has reduced interest rates substantially in an attempt to boost consumer spending due to the coronavirus pandemic which could have a sustained negative impact on our results of operations. The U.S. Congress has also passed massive stimulus packages (the "Coronavirus Aid, Relief, and Economic Security Act" and the "Coronavirus Response and Relief Supplemental Appropriations Act") intended to provide relief to consumers and small businesses, however the effectiveness of these packages could be disrupted by operational challenges in successfully implementing all of their provisions in a timely manner and could ultimately prove to be insufficient in scale.

Even with operational precautions we have implemented such as mask utilization, social distancing and disinfection of surfaces, the continued spread or prolonged impact of the coronavirus could negatively impact the availability of key personnel or significant numbers of our staff, who are necessary to conduct our business. Such a continued spread or outbreak could also impact the business and operations of third party service providers who perform critical services for our business. Similarly, the adverse impacts already seen by our commercial and retail customers from the pandemic, may be exacerbated or more prolonged than we currently anticipate. If the coronavirus spreads or the containment and mitigation response is unsuccessful for a prolonged period of time, we could experience a material adverse effect on our business, financial condition, and results of operations.

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

Market interest rates are beyond our control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, may negatively affect our ability to originate loans and leases, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately could affect our earnings.

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

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

We may be adversely impacted by the transition away from LIBOR as a reference interest rate — The London Interbank Offered Rate ("LIBOR") is a short-term interest rate used as a pricing reference for loans, derivatives and other financial instruments. In July 2017, the United Kingdom Financial Conduct Authority, which regulates the process for establishing LIBOR, announced that it intends to stop persuading or compelling banks to submit rates for the calculation of LIBOR after 2021. The exact impact this will have on financial markets and their individual participants is not currently known. Various substitute benchmarks are being considered in the marketplace but at this time it is not feasible to predict which of these will emerge as acceptable substitutes after 2021.

We have a significant number of loans and other financial instruments with attributes that are either directly or indirectly influenced by LIBOR. The impact of the transition away from LIBOR may adversely affect revenues, expenses and the value of those financial instruments. Such transition may also result in litigation with counterparties impacted by the transition as well as increased regulatory scrutiny and other adverse consequences. Any replacement benchmark ultimately adopted as a substitute for LIBOR may behave differently than LIBOR in a manner detrimental to our financial performance.

We convened a transition committee in 2019 to monitor market developments and implement a transition plan. Existing loans impacted by the transition are actively tracked, appropriate legal fallback language has been created and incorporated into documentation where appropriate and the we are an adhering party to the ISDA IBOR Fallbacks Protocol. We will continue to evaluate various alternatives should the industry fail to coalesce around a single suitable substitute. Although we are currently unable to assess what the ultimate impact of the transition from LIBOR will be, failure to adequately manage the transition could have a material adverse effect on our business, financial condition and results of operations.

__Liquidity Risks__

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

We rely on dividends from our subsidiaries — We receive substantially all of our revenue from dividends from our subsidiaries, including, primarily, the Bank. These dividends are the principal source of funds we use to pay dividends on our common stock and interest and principal on our debt. Various federal and state laws and regulations limit the amount of dividends our subsidiaries may pay to us. In the event our subsidiaries are unable to pay dividends to us, we may not be able to service debt, pay other obligations, or pay dividends on our common stock. Our inability to receive dividends from our subsidiaries could have a material adverse effect on our business, financial condition and results of operations.

__Operational Risks__

Our risk management framework could be ineffective and could have a material adverse effect on our ability to mitigate risks and/or losses — We have established a risk management framework to identify and manage our risk exposure. This framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which we are subject, including, credit, market, liquidity, operational, legal/compliance, and reputational risks. Our framework also includes financial, analytical and forecasting modeling methodologies which involve significant management assumptions and judgment that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Additionally, our Board of Directors has adopted a risk appetite statement in consultation with management which sets forth certain thresholds and limits to govern our overall risk profile. There can be no assurance that our risk management framework will be effective under all circumstances or that it will adequately identify, manage or limit any risk of loss to us. Any such failure in our risk management framework could have a material adverse effect on our business, financial condition, and results of operations.

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

Technology security breaches — Information security risks have increased due to the sophistication and activities of organized crime, hackers, terrorists and other external parties and the use of online, telephone, and mobile banking channels by clients. Any compromise of our security could deter our clients from using our banking services. We rely on security systems to provide the protection and authentication necessary to secure transmission of data against damage by theft, fire, power loss, telecommunications failure or similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms, and other disruptive problems caused by hackers. Computer break-ins, phishing and other disruptions of customer or vendor systems could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure. We maintain a cyber insurance policy that is designed to cover a majority of loss resulting from cyber security breaches.

We also confront the risk of being compromised by emails sent by perpetrators posing as company executives or vendors in order to dupe company personnel into sending large sums of money to accounts controlled by the perpetrators. We require all our employees to complete annual information security awareness training to increase their awareness of these risks and to engage them in our mitigation efforts. If these precautions are not sufficient to protect our systems from data breaches or compromises, our reputation and business could be adversely affected.

We depend on the services of a variety of third-party vendors to meet data processing and communication needs and we have contracted with third parties to run their proprietary software on our behalf. While we perform reviews of security controls instituted by the vendor in accordance with industry standards and institute our own internal security controls, we rely on continued maintenance of the controls by the outside party to safeguard our customer data.

Additionally, we issue debit cards which are susceptible to compromise at the point of sale via the physical terminal through which transactions are processed and by other means of hacking. The security and integrity of these transactions are dependent upon the retailers' vigilance and willingness to invest in technology and upgrades. Issuing debit cards to our clients exposes us to potential losses which, in the event of a data breach at one or more major retailers may adversely affect our business, financial condition, and results of operations.

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

Our accounting estimates rely on analytical and forecasting models — The processes we use to estimate our allowance for credit losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depend upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

Legal/Compliance Risks

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

Our investments and/or financings in certain tax-advantaged projects may not generate returns as anticipated and may have an adverse impact on our financial results — We invest and/or finance certain tax-advantaged projects promoting affordable housing, community redevelopment and renewable energy sources. Our investments in these projects are designed to generate a return primarily through the realization of federal and state income tax credits, and other tax benefits, over specified time periods. We are subject to the risk that previously recorded tax credits, which remain subject to recapture by taxing authorities based on compliance features required to be met at the project level, will fail to meet certain government compliance requirements and will not be able to be fully realized. The possible inability to realize these tax credits and other tax benefits can have a negative impact on our financial results. The risk of not being able to realize the tax credits and other tax benefits depends on many factors outside of our control, including changes in the applicable tax code and the ability of the projects to be completed and properly managed.

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

Reputational Risks

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

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

Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

Our headquarters building is located in downtown South Bend, Indiana. The building is part of a larger complex, including a 300-room hotel and a 500-car parking garage. In September 2019, we extended the lease on this property through September 2027. As of December 31, 2020, 1st Source leases approximately 71% of the office space in this complex.

At December 31, 2020, we owned or leased property and/or buildings where 1st Source Bank's 79 banking centers were located. Our facilities are located in Allen, DeKalb, Elkhart, Fulton, Huntington, Kosciusko, LaPorte, Marshall, Porter, Pulaski, St. Joseph, Starke, Tippecanoe, Wells, and Whitley Counties in the State of Indiana, Berrien, Cass, and Kalamazoo Counties in the State of Michigan, and Sarasota County in the state of Florida. 1st Source Bank also owns approximately 35 acres in St. Joseph County of which approximately 29 acres have been approved by the Board for development and construction of an operations and training facility. We are marketing the remaining six acres for sale. We anticipate moving forward with construction in 2021 subject to receiving appropriate agreements, approvals and authorizations from local city and county building and economic development authorities. Additionally, we utilize an operations center for business operations. The Bank leases additional property and/or buildings to and from third parties under lease agreements negotiated at arms-length.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

None

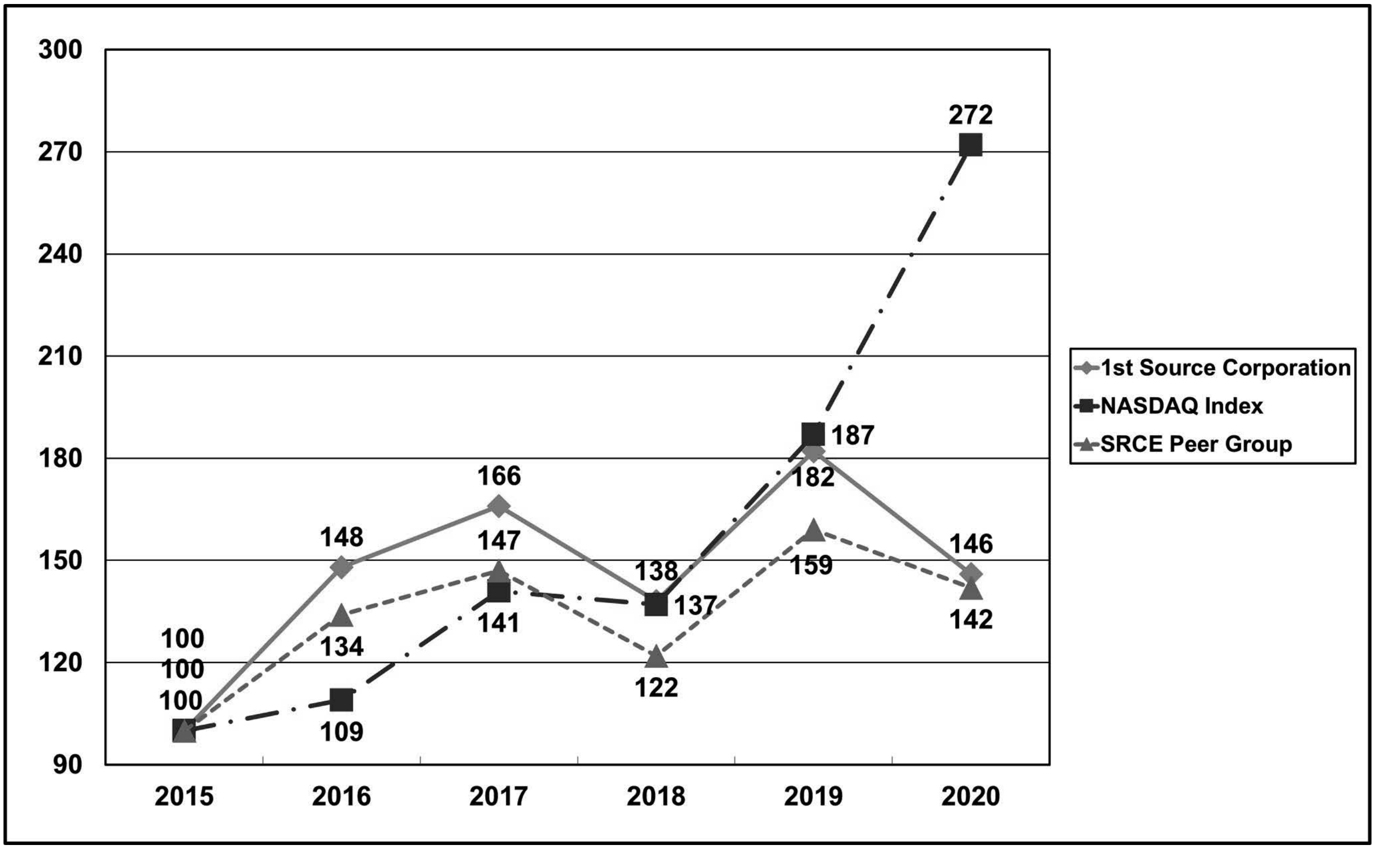
Part II

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

Our common stock is traded on the NASDAQ Global Select Market under the symbol "SRCE." As of February 12, 2021, there were 1,529 holders of record of 1st Source common stock.

Comparison of Five Year Cumulative Total Return*

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



* Assumes $100 invested on December 31, 2015, in 1st Source Corporation common stock, NASDAQ market index, and peer group index.

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

*** The peer group is a market-capitalization-weighted stock index of 34 banking companies in Illinois, Indiana, Michigan, Ohio, and Wisconsin. The following company included in this peer group in last year's annual report has not been included this year, due to being acquired during 2020: Mutual First Financial, Inc.

NOTE: Total return assumes reinvestment of dividends.

The following table shows our share repurchase activity during the three months ended December 31, 2020.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	Maximum Number (or Approximate Dollar Value) of Shares that may yet be Purchased Under the Plans or Programs
October 01 - 31, 2020	—	$ —	—	859,374
November 01 - 30, 2020	92,885	37.86	92,885	766,489
December 01 - 31, 2020	73,561	39.40	73,561	692,928

*1st Source maintains a stock repurchase plan that was authorized by the Board of Directors on July 24, 2014. Under the terms of the plan, 1st Source may repurchase up to 2,000,000 shares of its common stock from time to time to mitigate the potential dilutive effects of stock-based incentive plans and other potential uses of common stock for corporate purposes. Since the inception of the plan, 1st Source has repurchased a total of 1,307,072 shares.

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

Item 6. Selected Financial Data.

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

(Dollars in thousands, except per share amounts)	**2020**	2019	2018	2017	2016
Interest income	**$ 263,031**	$ 282,877	$ 257,316	$ 212,385	$ 191,760
Interest expense	**37,211**	59,011	43,410	26,754	22,101
Net interest income	**225,820**	223,866	213,906	185,631	169,659
Provision for credit losses	**36,001**	15,833	19,462	8,980	5,833
Net interest income after provision for credit losses	**189,819**	208,033	194,444	176,651	163,826
Noninterest income	**103,889**	101,130	97,050	98,706	88,945
Noninterest expense	**187,367**	189,009	186,467	173,997	163,645
Income before income taxes	**106,341**	120,154	105,027	101,360	89,126
Income taxes	**24,880**	28,139	22,613	33,309	31,340
Net income	**81,461**	92,015	82,414	68,051	57,786
Net income available to common shareholders	**$ 81,437**	$ 91,960	$ 82,414	$ 68,051	$ 57,786
Assets at year-end	**$ 7,316,411**	$ 6,622,776	$ 6,293,745	$ 5,887,284	$ 5,486,268
Long-term debt and mandatorily redeemable securities at year-end	**81,864**	71,639	71,123	70,060	74,308
Shareholders' equity at year-end	**886,845**	828,277	762,082	718,537	672,650
Basic net income per common share	**3.17**	3.57	3.16	2.60	2.22
Diluted net income per common share	**3.17**	3.57	3.16	2.60	2.22
Cash dividends per common share	**1.13**	1.10	0.96	0.76	0.72
Dividend payout ratio	**35.65 %**	30.81 %	30.48 %	29.23 %	32.45 %
Return on average assets	**1.14 %**	1.41 %	1.34 %	1.21 %	1.08 %
Return on average common shareholders' equity	**9.41 %**	11.50 %	11.09 %	9.69 %	8.71 %
Average common shareholders' equity to average assets	**12.15 %**	12.25 %	12.08 %	12.46 %	12.38 %

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

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

FORWARD-LOOKING STATEMENTS

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

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

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

- Local, regional, national, and international economic conditions and the impact they may have on us and our clients and our assessment of that impact.

- Changes in the level of nonperforming assets and charge-offs.
- Changes in estimates of future cash reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
- The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.
- Inflation, interest rate, securities market, and monetary fluctuations.
- Political instability.
- Acts of war or terrorism.
- The spread of infectious diseases or pandemics.
- Substantial changes in the cost of fuel.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by others.
- Changes in consumer spending, borrowings, and savings habits.
- Changes in the financial performance and/or condition of our borrowers.
- Technological changes.
- Acquisitions and integration of acquired businesses.
- The ability to increase market share and control expenses.
- The ability to expand effectively into new markets that we target.
- Changes in the competitive environment among bank holding companies.
- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities, and insurance) with which we and our subsidiaries must comply.
- The effect of changes in accounting policies and practices and auditing requirements, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standard setters.
- Changes in our organization, compensation, and benefit plans.
- The costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquires and the results of regulatory examinations or reviews.
- Greater than expected costs or difficulties related to the integration of new products and lines of business.
- Our success at managing the risks described in Item 1A. Risk Factors.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

Allowance for Credit Losses — The allowance for credit losses represents management's estimate of expected credit losses over the expected contractual life of our existing loan and lease portfolio and the establishment of an allowance that is sufficient to absorb those losses. As of December 31, 2020, we adopted ASU 2016-13 Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, as amended, which replaces the incurred loss methodology with an expected loss methodology that is referred to as current expected credit losses (CECL). We elected to delay adoption from January 1, 2020 until year-end (as provided by the CARES Act) principally to gain a better understanding of how the CECL model reacts to the severely adverse conditions as a result of the COVID-19 pandemic. The new accounting standard is being implemented at a time when we are experiencing conditions without historical precedent. Determining the appropriateness of the allowance is complex and requires judgement by management about the effect of matters that are inherently uncertain. In determining an appropriate allowance, management makes numerous judgments, assumptions, and estimates which are inherently subjective, as they require material estimates that may be susceptible to significant change. These estimates are derived based on continuous review of the loan and lease portfolio, assessments of client performance, movement through delinquency stages, probability of default, losses given default, collateral values, and disposition, as well as expected cash flows, economic forecasts, and qualitative factors, such as changes in current economic conditions.

As stated in Note 1, we segment our loan and lease portfolios based on similar risk characteristics for collective evaluation using a non-discounted cash flow approach to estimate expected losses. We use a cohort cumulative loss methodology for select loan and lease segments. The cohort methodology has a steady state assumption. For other segments, we use a PD/LGD (probability of default/loss given default) model which aligns well with our internal risk rating system. When we observe limitations in the data or models, we use model overlays to make adjustments to model outputs to capture a particular risk or compensate for a known limitation, or in the case of the cohort model, changes in the steady state assumptions. Actual losses may differ from estimated amounts due to model inefficiencies or management's inability to adequately determine appropriate model adjustment factors.

The new accounting standard further requires management to use forecasts about future economic conditions to determine the expected credit losses over the remaining life of the asset. Forecast adjustments are fundamentally difficult to establish and, in the current environment, due to uncertainty given the national pandemic and the political landscape, the task is even more formidable. Patterns from our history of normal business cycles are far less analogous to present economic conditions and consequently less relevant. We use a two-year reasonable and supportable period across all loan and lease segments to forecast economic conditions. We believe the two-year time horizon aligns with available industry guidance and various forecasting sources. Following this two-year forecasting period, we use a two-year reversion period to revert forecast rates to historical loss rates.

In assessing the factors used to derive an appropriate allowance, management benefits from a lengthy organizational history and experience with credit decisions and related outcomes, but is new to the application of CECL. We have been diligent in our efforts to gain a thorough understanding of the accounting standard, and have reviewed our portfolios, loan segmentations, methodologies and models and believe we have made appropriate and prudent decisions. Nonetheless, if management's underlying assumptions prove to be inaccurate, the allowance for loan and lease losses would have to be adjusted. Our accounting policies related to the allowance for credit losses is disclosed in Note 1 under the heading "Allowance for Credit Losses."

Fair Value Measurements — We use fair value measurements to record certain financial instruments and to determine fair value disclosures. Available-for-sale securities, trading account securities, mortgage loans held for sale, and interest rate swap agreements are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve write-downs of, or specific reserves against, individual assets. GAAP establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used in the measurement are observable or unobservable. Observable inputs reflect market-driven or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data.

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market data. For financial instruments that trade actively and have quoted market prices or observable market data, there is minimal subjectivity involved in measuring fair value. When observable market prices and data are not fully available, management judgment is necessary to estimate fair value. In addition, changes in the market conditions may reduce the availability of quoted prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. Therefore, when market data is not available, we use valuation techniques that require more management judgment to estimate the appropriate fair value measurement. Fair value is discussed further in Note 1 under the heading "Fair Value Measurements" and in Note 21, "Fair Value Measurements."

CORONAVIRUS (COVID-19) IMPACT

The following is a description of the impact the Coronavirus (COVID-19) pandemic is having on our financial condition and results of operations and certain risks to our business that the pandemic creates or exacerbates.

Operational Impact

Pursuant to our preexisting disaster recovery plan addressing potential pandemic outbreaks, we created a dedicated executive COVID-19 response team that is closely monitoring developments and providing guidance for additional precautions and initiatives. We have divided departments among various locations to help ensure that infection will not spread across entire departments. We are encouraging virtual meetings and conference calls in place of in-person meetings, including our annual shareholder meeting which was held virtually this year and will again be held virtually in 2021. Employees with health conditions putting them at higher risk of adverse effects from coronavirus infection have been given the opportunity to work remotely. Additionally, travel has been restricted. We are promoting social distancing, frequent hand washing, disinfection of all surfaces, and the use of masks or nose and mouth coverings have been mandated in all of our locations. The majority of our banking center lobbies have been open only for advance appointments. Banking center drive-ups, ATMs and online/mobile banking services continue to operate normally. It remains undetermined how long our banking centers will operate at these service levels. Infection rates in the communities we serve vary by region and we will make prudent decisions for the safety of our colleagues and our clients.

Loan and lease modifications

We began receiving requests from our borrowers for loan and lease deferrals in March. Modifications include the deferral of principal payments or the deferral of principal and interest payments for terms generally 90 - 180 days. Requests are evaluated individually and approved modifications are based on the unique circumstances of each borrower. We are committed to working with our clients to allow time to work through the challenges of this pandemic. At this time, it is uncertain what future impact loan and lease modifications related to COVID-19 difficulties will have on our financial condition, results of operations and allowance for loan and lease losses. The following table shows coronavirus loan and lease modification balances in deferment as of December 31, 2020, September 30, 2020 and June 30,2020, respectively.

	COVID-19 Related Loan and Lease Modifications		
(Dollars in millions)	**December 31, 2020**	**September 30, 2020**	**June 30, 2020**
Auto and light truck rental	$ 5	$ 22	$ 224
Specialty vehicle[(1)]	21	23	75
Medium and heavy duty truck	—	5	87
Aircraft	13	13	93
Construction	7	—	139
Commercial	83	63	210
Residential real estate and home equity	—	—	4
Consumer	—	—	8
Total loans and leases	$ 129	$ 126	$ 840

(1) Includes buses, step vans and funeral cars.

The following table shows the coronavirus loan and lease modification balances by deferral type as of December 31, 2020.

(Dollars in millions)	Principal Only Deferrals	Principal and Interest Deferrals	Total Modifications in Deferment	Additional Modifications Expected(1)	Total Modifications	Recorded Investment at December 31, 2020	Total Modifications as a % of December 31, 2020 Balance
Auto and light truck rental	$ 1	$ 4	$ 5	$ 1	$ 6	$ 409	1 %
Specialty vehicle(2)	19	2	21	20	41	133	31 %
Medium and heavy duty truck	—	—	—	—	—	279	— %
Aircraft	13	—	13	—	13	861	2 %
Construction	7	—	7	—	7	715	1 %
Commercial	20	63	83	18	101	2,449	4 %
Residential real estate and home equity	—	—	—	—	—	511	— %
Consumer	—	—	—	—	—	132	— %
Total loans and leases	60	69	129	39	168	5,489	3 %
PPP loans, net of unearned discount(3)	—	—	—	—	—	352	— %
Total loans and leases less PPP loans	$ 60	$ 69	$ 129	$ 39	$ 168	$ 5,137	3 %

(1) Represents modifications which ended deferment during December 2020 and are in the process of receiving or expected to receive an extension.

(2) Includes buses, step vans and funeral cars.

(3) PPP loan balances are located within the Commercial category above.

As of December 31, 2020, COVID-19 related loan modifications for our bus lending were $40.23 million or 56.27% (includes $19.77 million whose modification period ended during December but we expect to grant further extensions) of our total bus loan balances. COVID-19 related loan modifications for the hotel industry were $79.97 million or 50.69% (includes $12.33 million whose modification period ended during December but we expect to grant further extensions) of our total hotel loan balances. Hotel loans are shown within the Commercial category in the charts above and below.

With the imposition of travel restrictions as a result of taking steps to slow the spread of COVID-19, our bus clients were immediately impacted resulting in numerous deferral requests. We initially granted three-month deferrals to many of these clients, most of which were principal and interest deferrals. During the year, we sent questionnaires to all of our bus clients in order to gain a better understanding of their situation, their customer base and the likely long-term impact of the economic downturn on their business model, i.e. their ability to withstand reduced revenue for an extended period of time. We differentiated our bus clients based on the underlying risks in their business models and management teams. In order to differentiate collateral types, we created tiers from more desirable to less desirable collateral pools and valued the units accordingly, using deeper discount rates against collateral deemed less desirable. We tried to assess our client's outlook and their ability to manage through several more months of extreme distress. We gathered information on how they are maintaining their assets and if the units are currently insured. We are diligently working with these clients to try to keep them in business. The CARES Act did not provide much benefit to this sector, however the recently enacted Coronavirus Response and Relief Supplemental Appropriations Act offers targeted transportation funds which are expected to afford some relief. We have extended three rounds of three-month deferrals and will continue to agree to a fourth round of deferrals if we think that our borrowers can continue to support the maintenance and insurance of their units. Generally, this round we are granting principal only deferrals and extending the deferral period for six months in the hopes that activity will begin to increase during the summer months of 2021. Our intent is to repossess collateral as a last result. If the borrower cannot maintain the assets, we will move to take them back either voluntarily or by legal action. We expect long holding periods until we will be able to sell any repossessed units. So far, we have limited repossessed bus assets, $1.09 million as of December 31, 2020, but this number will likely increase.

The following table shows the coronavirus loan and lease modification balances. Modification terms generally ranged between three and six months depending on industry.

	First Modification			Second Modification			Three or More Modifications		
(Dollars in millions)	Expired	In Deferment	Total	Expired	In Deferment[(1)]	Total	Expired	In Deferment[(1)]	Total
Auto and light truck rental	$ 273	$ 1	$ 274	$ 78	$ 4	$ 82	$ 20	$ 1	$ 21
Specialty vehicle[(2)]	89	—	89	74	2	76	44	39	83
Medium and heavy duty truck	89	—	89	5	—	5	—	—	—
Aircraft	97	—	97	17	13	30	—	—	—
Construction	144	7	151	9	—	9	1	—	1
Commercial	208	45	253	22	49	71	8	7	15
Residential real estate and home equity	7	—	7	—	—	—	—	—	—
Consumer	9	—	9	—	—	—	—	—	—
Total loans and leases	$ 916	$ 53	$ 969	$ 205	$ 68	$ 273	$ 73	$ 47	$ 120

(1) Includes modifications which ended deferment during December 2020 and are in the process of receiving or expected to receive an extension.

(2) Includes buses, step vans and funeral cars.

Paycheck Protection Program (PPP) and Liquidity

As part of the CARES Act, approved by the President on March 27, 2020 and extended on July 4, 2020, the Small Business Administration (SBA) was authorized to guarantee loans under the PPP through August 8, 2020 for businesses who met the necessary eligibility requirements in order to keep their workers on the payroll. We began accepting applications on April 3, 2020 and disbursed the final PPP loan on August 25, 2020. PPP loans are fully guaranteed by the SBA and as such do not represent a credit risk. The following table shows PPP loan disbursements as of December 31, 2020.

	Number of Loans	$ of Loans (000's)	Average Loan Size
Phase One	2,024	$ 520,583	$ 257,000
Phase Two	1,516	76,868	51,000
Total	3,540	$ 597,451	$ 169,000

As of December 31, 2020, PPP loan balances were $351.56 million which is net of an unearned discount of $6.37 million and located within the commercial and agricultural portfolio. At December 31, 2020, specialty finance customers had $78.35 million of PPP loans and traditional commercial banking customers had $273.21 million of PPP loans.

On October 8, 2020, the SBA announced a streamlined loan forgiveness application for loans $50,000 or less. Of the 3,540 PPP loans we originated, 1,972 loans were for $50,000 or less. As of December 31, 2020, we had helped our clients secure forgiveness for $236.25 million and had submitted loan forgiveness requests to the SBA for over 60% of the total PPP loans amounts we funded during 2020.

On April 9, 2020, the FDIC, Federal Reserve and OCC created the Paycheck Protection Program Liquidity Facility (PPPLF) to bolster the effectiveness of the PPP by providing liquidity to and neutralizing the regulatory capital effects on participating financial institutions. As of December 31, 2020, we had not utilized the PPPLF.

Asset impairment

Our MSRs have experienced a decrease in their fair value as of December 31, 2020 resulting in year-to-date impairment charges of $0.81 million due to lower mortgage rates leading to faster prepayment speeds. We will continue to evaluate MSRs at each reporting date to determine whether further valuation allowances are appropriate.

We evaluate goodwill for impairment during the fourth quarter of each year, with financial data as of September 30. Based on the analysis performed as of October 1, 2019, we determined that goodwill for our reporting units was not impaired. During the first quarter of 2020, management determined that the deterioration in general economic conditions as a result of the COVID-19 pandemic and responses thereto represented a triggering event prompting an evaluation of goodwill impairment. Based on the analyses performed during the first, second, third, and fourth quarters of 2020, we determined that goodwill was not impaired.

At this time, we do not believe there exists any impairment to our intangible assets, long-lived assets, right of use assets, or available-for-sale investment securities due to the COVID-19 pandemic. It is uncertain whether prolonged effects of the COVID-19 pandemic will result in future impairment charges related to any of the aforementioned assets.

Risks

See Part I. Business, Item 1A, Risk Factors for more information.

Allowance for loan and lease losses

During 2020, we experienced increasing downgrades and defaults as a result of COVID-19 as evidenced by increasing special attention and nonperforming loan balances. Special attention loan balances increased $76.22 million since December 31, 2019 and we anticipate special attention levels to remain high with further downgrades in 2021. Likewise, nonperforming loans increased $50.41 million since last year-end. We are in communication with our clients to gain a better understanding of our highest risk exposures and probable defaults. As a result of the discussions with our clients, we downgraded an additional 39 bus accounts to special attention and placed several of these accounts on nonaccrual status. We anticipate defaults to continue into 2021 but at a reduced pace. Furthermore, the bus collateral may be difficult to liquidate, particularly in this environment. We believe our auto rental customers will continue to struggle; however, vehicle auctions are well established and are an effective means of liquidating collateral and used vehicle values, to date, have remained strong, so our loss exposure is well managed. Some of our construction clients are impacted by low commodity prices, particularly for oil, which recently has shown some improvement. Our local market clients have been buoyed in the short-term with funds from the PPP program. The passage of the Coronavirus Response and Relief Supplemental Appropriations Act in late December will provide further stimulus for many of these clients. Thus far, we have not seen many downgrades or defaults in our commercial lending, but we anticipate this could change particularly as businesses continue to struggle. During the last recession, we also noted a delayed impact on our commercial lending as compared to our specialty finance lending. Our losses for 2020 were moderate. We continue to maintain the allowance for loan and lease losses at an appropriate level as we anticipate some of the current and future downgrades and defaults will eventually result in losses.

See Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Credit Experience" and Part II, Item 8, Financial Statements and Supplementary Data — Note 5 of the Notes to Consolidated Financial Statements for more information.

EARNINGS SUMMARY

Net income available to common shareholders in 2020 was $81.44 million, down from $91.96 million in 2019 and down from $82.41 million in 2018. Diluted net income per common share was $3.17 in 2020, $3.57 in 2019, and $3.16 in 2018. Return on average total assets was 1.14% in 2020 compared to 1.41% in 2019, and 1.34% in 2018. Return on average common shareholders' equity was 9.41% in 2020 versus 11.50% in 2019, and 11.09% in 2018.

Net income in 2020, as compared to 2019, was positively impacted by a $1.95 million or 0.87% increase in net interest income, a $2.76 million or 2.73% increase in noninterest income, a $1.64 million or 0.87% decrease in noninterest expense, and a $3.26 million or 11.58% decrease in income tax expense which was offset by a $20.17 million or 127.38% increase in provision for credit losses. Net income in 2019 was positively impacted by a $9.96 million or 4.66% increase in net interest income, a $4.08 million or 4.20% increase in noninterest income, and a $3.63 million or 18.65% decrease in provision for credit losses which was offset by a $5.53 million or 24.44% increase in income tax expense and a $2.54 million or 1.36% increase in noninterest expense over 2018.

Dividends paid on common stock in 2020 amounted to $1.13 per share, compared to $1.10 per share in 2019, and $0.96 per share in 2018. The level of earnings reinvested and dividend payouts are determined by the Board of Directors based on management's assessment of future growth opportunities and the level of capital necessary to support them.

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

Net interest margin (the ratio of net interest income to average earning assets) is significantly affected by movements in interest rates and changes in the mix of earning assets and the liabilities that fund those assets. Net interest margin on a fully taxable-equivalent basis was 3.39% in 2020, compared to 3.68% in 2019 and 3.73% in 2018. Net interest income was $225.82 million for 2020, compared to $223.87 million for 2019 and $213.91 million for 2018. Tax-equivalent net interest income totaled $226.36 million for 2020, up $1.81 million from the $224.55 million reported in 2019. Tax-equivalent net interest income for 2019 was up $9.84 million from the $214.71 reported for 2018.

During 2020, average earning assets increased $579.57 million or 9.49% while average interest-bearing liabilities increased $105.64 million or 2.38% over the comparable period in 2019. The yield on average earning assets decreased 71 basis points to 3.94% for 2020 from 4.65% for 2019 primarily due to lower rates on loans and leases. Total cost of average interest-bearing liabilities decreased 51 basis points to 0.82% during 2020 from 1.33% in 2019 as a result of the lower interest rate environment during 2020. The result to the fully taxable-equivalent net interest margin was a decrease of 29 basis points.

The largest contributor to the decrease in the yield on average earning assets in 2020 was the 72 basis point decline in the loan and lease portfolio yield primarily due to market conditions as a result of 2020 Federal Reserve interest rate decreases. Average net loans and leases increased $463.28 million or 9.27% in 2020 from 2019 while the yield decreased to 4.44%. The largest contributor to the increase in average net loans and leases was Paycheck Protection Program average loan balances of $376.43 million in 2020. Although the stated interest rate on PPP loans was 1.0%, the PPP impact on the overall loan and lease yield was immaterial due to the recognition of $12.06 million in related loan fees during 2020.

During 2020, the tax-equivalent yield on investment securities available-for-sale decreased 42 basis points to 1.81% while the average balance grew $43.40 million. Average mortgages held for sale increased $5.03 million during 2020 while the yield decreased 100 basis points. Average other investments, which include federal funds sold, time deposits with other banks, Federal Reserve Bank excess balances, Federal Reserve Bank and Federal Home Loan Bank (FHLB) stock and commercial paper increased $67.87 million during 2020 while the yield decreased 211 basis points. The decrease in yield for mortgages held for sale and other investments was primarily a result of higher outstanding balances at lower rates.

Average interest-bearing deposits increased $100.81 million or 2.46% during 2020 while the effective rate paid on those deposits decreased 51 basis points. The decline in the average cost of interest-bearing deposits was primarily the result of lower rates and a shift in the deposit mix. Average noninterest-bearing demand deposits increased $359.06 million or 30.65% during 2020.

Average short-term borrowings decreased $4.75 million during 2020 while the effective rate paid decreased 68 basis points. The decrease in short-term borrowings was primarily the result of decreased borrowings with the Federal Home Loan Bank. Average long-term debt and mandatorily redeemable securities balances increased $9.58 million during 2020 as the effective rate decreased 53 basis points primarily due to lower rates on mandatorily redeemable securities.

The following table provides an analysis of net interest income and illustrates interest income earned and interest expense charged for each major component of interest earning assets and the interest bearing liabilities. Yields/rates are computed on a tax-equivalent basis, using a 21% rate. Nonaccrual loans and leases are included in the average loan and lease balance outstanding.

	2020			2019			2018		
(Dollars in thousands)	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
ASSETS									
Investment securities available-for-sale:									
Taxable	**$ 1,009,794**	**$ 18,080**	**1.79 %**	$ 945,396	$ 20,946	2.22 %	$ 861,733	$ 19,356	2.25 %
Tax-exempt[1]	**48,266**	**1,105**	**2.29 %**	69,263	1,662	2.40 %	90,079	2,293	2.55 %
Mortgages held for sale	**20,628**	**600**	**2.91 %**	15,601	610	3.91 %	8,190	372	4.54 %
Loans and leases, net of unearned discount[1]	**5,463,436**	**242,505**	**4.44 %**	5,000,161	258,113	5.16 %	4,755,256	234,450	4.93 %
Other investments	**142,122**	**1,284**	**0.90 %**	74,252	2,232	3.01 %	46,503	1,648	3.54 %
Total earning assets[1]	**6,684,246**	**263,574**	**3.94 %**	6,104,673	283,563	4.65 %	5,761,761	258,119	4.48 %
Cash and due from banks	**71,626**			67,726			64,853		
Allowance for loan and lease losses	**(130,776)**			(105,340)			(99,258)		
Other assets	**494,913**			461,215			424,083		
Total assets	**$ 7,120,009**			$ 6,528,274			$ 6,151,439		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing deposits	**$ 4,205,904**	**$ 30,459**	**0.72 %**	$ 4,105,097	$ 50,495	1.23 %	$ 3,893,999	$ 34,631	0.89 %
Short-term borrowings	**201,165**	**517**	**0.26 %**	205,911	1,934	0.94 %	265,041	2,838	1.07 %
Subordinated notes	**58,764**	**3,367**	**5.73 %**	58,764	3,677	6.26 %	58,764	3,625	6.17 %
Long-term debt and mandatorily redeemable securities	**80,715**	**2,868**	**3.55 %**	71,133	2,905	4.08 %	70,813	2,316	3.27 %
Total interest-bearing liabilities	**4,546,548**	**37,211**	**0.82 %**	4,440,905	59,011	1.33 %	4,288,617	43,410	1.01 %
Noninterest-bearing deposits	**1,530,698**			1,171,639			1,069,664		
Other liabilities	**145,807**			106,945			49,791		
Shareholders' equity	**865,278**			799,736			743,173		
Noncontrolling interests	**31,678**			9,049			194		
Total liabilities and equity	**$ 7,120,009**			$ 6,528,274			$ 6,151,439		
Less: Fully tax-equivalent adjustments		**(543)**			(686)			(803)	
Net interest income/margin (GAAP-derived)[1]		**$ 225,820**	**3.38 %**		$ 223,866	3.67 %		$ 213,906	3.71 %
Fully tax-equivalent adjustments		**543**			686			803	
Net interest income/margin - FTE[1]		**$ 226,363**	**3.39 %**		$ 224,552	3.68 %		$ 214,709	3.73 %

(1) See "Reconciliation of Non-GAAP Financial Measures" for more information on this performance measure/ratio.

Reconciliation of Non-GAAP Financial Measures — Our accounting and reporting policies conform to GAAP in the United States and prevailing practices in the banking industry. However, certain non-GAAP performance measures are used by management to evaluate and measure the Company's performance. These include taxable-equivalent net interest income (including its individual components) and net interest margin (including its individual components). Management believes that these measures provide users of the Company's financial information a more meaningful view of the performance of the interest-earning assets and interest-bearing liabilities.

Management reviews yields on certain asset categories and the net interest margin of the Company and its banking subsidiaries on a fully taxable-equivalent ("FTE") basis. In this non-GAAP presentation, net interest income is adjusted to reflect tax-exempt interest income on an equivalent before-tax basis. This measure ensures comparability of net interest income arising from both taxable and tax-exempt sources. The following table shows the reconciliation of non-GAAP financial measures for the most recent three years ended December 31.

	(Dollars in thousands)	**2020**	2019	2018
	Calculation of Net Interest Margin			
(A)	Interest income (GAAP)	**$ 263,031**	$ 282,877	$ 257,316
	Fully tax-equivalent adjustments:			
(B)	- Loans and leases	**333**	375	367
(C)	- Tax-exempt investment securities	**210**	311	436
(D)	Interest income - FTE (A+B+C)	**263,574**	283,563	258,119
(E)	Interest expense (GAAP)	**37,211**	59,011	43,410
(F)	Net interest income (GAAP) (A-E)	**225,820**	223,866	213,906
(G)	Net interest income - FTE (D-E)	**226,363**	224,552	214,709
(H)	Total earning assets	**$ 6,684,246**	$ 6,104,673	$ 5,761,761
	Net interest margin (GAAP-derived) (F/H)	**3.38 %**	3.67 %	3.71 %
	Net interest margin - FTE (G/H)	**3.39 %**	3.68 %	3.73 %

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

	Increase (Decrease) due to		
(Dollars in thousands)	Volume	Rate	Net
2020 compared to 2019			
Interest earned on:			
Investment securities available-for-sale:			
Taxable	**$ 1,355**	**$ (4,221)**	**$ (2,866)**
Tax-exempt	**(484)**	**(73)**	**(557)**
Mortgages held for sale	**169**	**(179)**	**(10)**
Loans and leases, net of unearned discount	**22,581**	**(38,189)**	**(15,608)**
Other investments	**1,232**	**(2,180)**	**(948)**
Total earning assets	**$ 24,853**	**$ (44,842)**	**$ (19,989)**
Interest paid on:			
Interest-bearing deposits	**$ 1,211**	**$ (21,247)**	**$ (20,036)**
Short-term borrowings	**(44)**	**(1,373)**	**(1,417)**
Subordinated notes	**—**	**(310)**	**(310)**
Long-term debt and mandatorily redeemable securities	**365**	**(402)**	**(37)**
Total interest-bearing liabilities	**$ 1,532**	**$ (23,332)**	**$ (21,800)**
Net interest income - FTE	**$ 23,321**	**$ (21,510)**	**$ 1,811**
2019 compared to 2018			
Interest earned on:			
Investment securities available-for-sale:			
Taxable	$ 1,857	$ (267)	$ 1,590
Tax-exempt	(506)	(125)	(631)
Mortgages held for sale	296	(58)	238
Loans and leases, net of unearned discount	12,371	11,292	23,663
Other investments	864	(280)	584
Total earning assets	$ 14,882	$ 10,562	$ 25,444
Interest paid on:			
Interest-bearing deposits	$ 1,967	$ 13,897	$ 15,864
Short-term borrowings	(583)	(321)	(904)
Subordinated notes	—	52	52
Long-term debt and mandatorily redeemable securities	11	578	589
Total interest-bearing liabilities	$ 1,395	$ 14,206	$ 15,601
Net interest income - FTE	$ 13,487	$ (3,644)	$ 9,843

Noninterest Income — Noninterest income increased $2.76 million or 2.73% in 2020 from 2019 following a $4.08 million or 4.20% increase in 2019 over 2018. The following table shows noninterest income for the most recent three years ended December 31.

(Dollars in thousands)	**2020**	2019	2018
Noninterest income:			
Trust and wealth advisory	**$ 21,114**	$ 20,692	$ 21,071
Service charges on deposit accounts	**9,485**	11,010	10,454
Debit card	**14,983**	14,209	13,369
Mortgage banking	**15,674**	4,698	3,844
Insurance commissions	**7,025**	6,761	6,502
Equipment rental	**23,380**	30,741	31,793
Gains (losses) on investment securities available-for-sale	**279**	—	(345)
Other	**11,949**	13,019	10,362
Total noninterest income	**$ 103,889**	$ 101,130	$ 97,050

Trust and wealth advisory fees (which include investment management fees, estate administration fees, mutual fund fees, annuity fees, and fiduciary fees) increased $0.42 million or 2.04% in 2020 from 2019 compared to a $0.38 million or 1.80% decrease in 2019 over 2018. Trust and wealth advisory fees are largely based on the number and size of client relationships and the market value of assets under management. The market value of trust assets under management at December 31, 2020 and 2019 was $4.74 billion and $4.48 billion, respectively. Stock market recoveries during the fourth quarter of 2020 helped improve the market value of trust assets under management. At December 31, 2020, these trust assets were comprised of $3.04 billion of personal and agency trusts and estate administration assets, $1.09 billion of employee benefit plan assets, $485.03 million of individual retirement accounts, and $120.76 million of custody assets.

Service charges on deposit accounts decreased by $1.53 million or 13.85% in 2020 from 2019 compared to an increase of $0.56 million or 5.32% in 2019 from 2018. The decrease in service charges on deposit accounts in 2020 was primarily due to a lower volume of nonsufficient fund transactions and reduced ATM fees. The increase in service charges on deposit accounts in 2019 primarily reflects a higher volume of nonsufficient fund transactions.

Debit card income improved $0.77 million or 5.45% in 2020 from 2019 compared to an increase of $0.84 million or 6.28% in 2019 from 2018. The increase in 2020 and 2019 was mainly the result of an increased volume of debit card transactions.

Mortgage banking income increased $10.98 million or 233.63% in 2020 over 2019, compared to a $0.85 million or 22.22% increase in 2019 from 2018. We had $0.81 million of MSR impairment in 2020 as a result of increased prepayment speeds compared to none in 2019 or 2018. During 2020, 2019 and 2018, we determined that no permanent write-down was necessary for previously recorded impairment on MSRs. During 2020, mortgage banking income increased primarily due to better margins on a higher volume of loan sales as a result of more loans originated for the secondary market offset by the $0.81 million of MSR impairment charges. During 2019, mortgage banking income increased primarily due to improved gains on a higher volume of loans sold as a result of more loans originated for the secondary market.

Insurance commissions grew $0.26 million or 3.90% in 2020 compared to 2019 and improved $0.26 million or 3.98% in 2019 compared to 2018. The increase in 2020 was primarily due to new business offset by a reduction in contingent commissions received. The increase in insurance commissions during 2019 was mainly due to an increase in the book of business and higher contingent commissions received resulting from increased sales and lower client claims.

Equipment rental income generated from operating leases decreased by $7.36 million or 23.95% during 2020 from 2019 compared to a decrease of $1.05 million or 3.31% during 2019 from 2018. The average equipment rental portfolio decreased 23.36% in 2020 over 2019 as a result of reduced leasing volume primarily in the construction equipment, aircraft, and auto and light truck portfolios and decreased 3.48% in 2019 over 2018 as a result of reduced leasing volume primarily in the construction and medium and heavy duty truck portfolios offset by a slight increase in the specialty vehicle portfolio. In 2020 and 2019, the decrease in rental income was offset by a similar decrease in depreciation on equipment owned under operating leases.

Gains on the sale of investment securities available-for-sale during 2020 were $0.28 million. There were no sales of investment securities available-for-sale for the year ended 2019. Sales of investment securities available-for-sale resulted in net losses of $0.35 million for the year ended 2018. Gains on the sale of investment securities available-for-sale in 2020 were primarily from the sale of corporate securities in managing portfolio risk. During 2018, losses on the sale of investment securities available-for-sale were primarily the result of repositioning the investment portfolio during the first quarter in response to tax reform.

Other income decreased $1.07 million or 8.22% in 2020 from 2019 compared to an increase of $2.66 million or 25.64% in 2019 from 2018. The decline in 2020 was mainly a result of nonrecurring rental income on a repossessed asset of $0.96 million during 2019, which was not present in 2020, and a decrease in customer swap fees offset by higher gains on partnership investments. The improvement in 2019 was mainly a result of nonrecurring rental income on a repossessed asset of $0.96 million, higher claim proceeds from bank owned life insurance, and an increase in customer swap fees. The increase was also helped by personal property tax reimbursements on leased equipment from lessees of $0.73 million that were reported gross as required by the new leasing standard effective January 1, 2019.

Noninterest Expense — Noninterest expense decreased $1.64 million or 0.87% in 2020 over 2019 following a $2.54 million or 1.36% increase in 2019 from 2018. The following table shows noninterest expense for the most recent three years ended December 31.

(Dollars in thousands)	**2020**	2019	2018
Noninterest expense:			
Salaries and employee benefits	**$ 101,556**	$ 97,098	$ 93,857
Net occupancy	**10,276**	10,528	10,041
Furniture and equipment	**25,688**	24,815	23,433
Depreciation — leased equipment	**20,203**	25,128	26,248
Professional fees	**6,317**	6,952	7,680
Supplies and communications	**5,563**	6,454	6,320
FDIC and other insurance	**2,606**	1,795	2,923
Business development and marketing	**4,157**	6,303	6,112
Loan and lease collection and repossession	**3,099**	3,402	3,375
Other	**7,902**	6,534	6,478
Total noninterest expense	**$ 187,367**	$ 189,009	$ 186,467

Total salaries and employee benefits increased $4.46 million or 4.59% in 2020 from 2019, following a $3.24 million or 3.45% increase in 2019 from 2018.

Employee salaries increased $4.71 million or 6.03% in 2020 from 2019 compared to an increase of $1.00 million or 1.29% in 2019 from 2018. The increase in 2020 was mainly a result of higher base salaries due to normal merit increases, a rise in commission compensation primarily in our residential mortgage area as well as a one-time special award made to most employees at the end of 2020 as recognition for the dedication they have shown in serving our clients and embracing their role as essential workers. The increase in 2019 was mainly a result of higher base salaries due to normal merit increases and a slight increase in full-time equivalent employees offset by a decrease in incentive compensation due to fewer vestings of share-based compensation arrangements.

Employee benefits decreased $0.25 million or 1.31% in 2020 from 2019, compared to a $2.25 million or 13.38% increase in 2019 from 2018. During 2020, group insurance costs decreased as a result of overall lower health insurance claims experience offset by higher company contributions to employee retirement accounts. In 2019, group insurance costs increased as a result of overall higher health insurance claims experience, administrative expenses and stop loss premiums and higher company contributions to employee retirement accounts.

Occupancy expense declined $0.25 million or 2.39% in 2020 from 2019, compared to an increase of $0.49 million or 4.85% in 2019 from 2018. The reduced expense in 2020 was primarily the result of lower repair expenses offset by increased building depreciation. The higher expense in 2019 was primarily the result of the Company leasing office space in its former headquarters building which sold during the first quarter of 2019 offset by reduced snow removal costs and lower utility expenses compared to 2018.

Furniture and equipment expense, including depreciation, grew by $0.87 million or 3.52% in 2020 from 2019 compared to an increase of $1.38 million or 5.90% in 2019 from 2018. The higher expense in 2020 was primarily due to computer processing charges and increased software maintenance expense offset by a reduction in equipment depreciation. The higher expense in 2019 was primarily due to increased software maintenance costs.

Depreciation on equipment owned under operating leases decreased $4.93 million or 19.60% in 2020 from 2019, following a $1.12 million or 4.27% decrease in 2019 from 2018. In 2020 and 2019, depreciation on equipment owned under operating leases correlated with the change in equipment rental income.

Professional fees declined $0.64 million or 9.13% in 2020 from 2019, compared to a $0.73 million or 9.48% decrease in 2019 from 2018. The lower expense in 2020 was primarily due to reduced utilization of consulting services offset by an increase in board of directors fees. The lower expense in 2019 compared to 2018 was primarily due to reduced utilization of consulting services as 2018 projects were completed.

Supplies and communications expense decreased $0.89 million or 13.81% in 2020 from 2019, and increased $0.13 million or 2.12% in 2019 from 2018. The decline during 2020 was due to lower printing costs, telephone line and equipment expenses and postage fees. The increase in 2019 resulted primarily from higher printing costs were offset by lower telephone service expenses.

FDIC and other insurance expense increased $0.81 million or 45.18% in 2020 from 2019 and decreased $1.13 million or 38.59% in 2019 from 2018. The increase in 2020 and the decrease in 2019 was mainly due to $0.88 million in FDIC insurance premium credits received during 2019 compared to $0.55 million in 2020.

Business development and marketing expenses declined $2.15 million or 34.05% in 2020 from 2019 and increased $0.19 million or 3.13% in 2019 from 2018. The lower expense in 2020 was mainly the result of decreased business development expense as a result of fewer business entertainment and travel opportunities tied to COVID-19 precautions and a reduction in marketing promotions. The higher expense in 2019 was mainly the result of additional marketing promotions.

Loan and lease collection and repossession expenses decreased $0.30 million or 8.91% in 2020 from 2019 compared to an increase of $0.03 million or 0.80% in 2019 from 2018. Loan and lease collection and repossession expense was lower in 2020 primarily due to fewer valuation adjustments on repossessed assets offset by increased general collection and repossession expenses. The increase in 2019 was mainly due to increased valuation adjustments on repossessed assets and fewer gains on the sale of repossessed assets offset by less legal fees on collection and repossession activity.

Other expenses were higher by $1.37 million or 20.94% in 2020 as compared to 2019 and increased $0.06 million or 0.86% in 2019 as compared to 2018. The increase in 2020 was primarily the result of lower gains on the sale of fixed assets, a rise in the provision for unfunded loan commitments, a higher provision for interest rate swaps with customers, and a loss on operating lease equipment offset by lower employee training expenses due to COVID-19 travel precautions and higher gains of the sale of operating lease equipment. The increase in 2019 was mainly the result of higher credit report and appraisal fees on greater loan volume, an increase in the interest rate swap valuation provision and higher professional membership dues and subscriptions offset by a $1.31 million gain on the sale of a fixed asset. Additionally, other expense during 2019 included personal property taxes on leased equipment of $0.73 million that are reported gross as required by the new leasing standard effective January 1, 2019.

Income Taxes — 1st Source recognized income tax expense in 2020 of $24.88 million, compared to $28.14 million in 2019, and $22.61 million in 2018. The effective tax rate in 2020 was 23.40% compared to 23.42% in 2019, and 21.53% in 2018. The 2018 provision for income taxes included a $0.80 million benefit from a state tax settlement and a $0.88 million benefit from finalization of the provisional amounts recorded at December 31, 2017 related to the impact of the federal tax rate change. The impact of those items resulted in an effective rate decrease from 23.13% to 21.53% during 2018.

For a detailed analysis of 1st Source's income taxes see Part II, Item 8, Financial Statements and Supplementary Data — Note 17 of the Notes to Consolidated Financial Statements.

FINANCIAL CONDITION

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

(Dollars in thousands)	**2020**	2019	2018	2017	2016
Commercial and agricultural	**$ 1,478,722**	$ 1,132,791	$ 1,073,205	$ 929,997	$ 812,264
Auto and light truck	**542,369**	588,807	559,987	496,816	411,764
Medium and heavy duty truck	**279,172**	294,824	283,544	296,935	294,790
Aircraft	**861,460**	784,040	803,111	844,657	802,414
Construction equipment	**714,888**	705,451	645,239	563,437	495,925
Commercial real estate	**969,864**	908,177	809,886	741,568	719,170
Residential real estate and home equity	**511,379**	532,003	523,855	526,122	521,931
Consumer	**131,447**	139,434	136,637	128,146	129,813
Total loans and leases	**$ 5,489,301**	$ 5,085,527	$ 4,835,464	$ 4,527,678	$ 4,188,071

At December 31, 2020, 10.8% of total loans and leases were concentrated with non-owner occupied commercial real estate.

Loans and leases, net of unearned discount, at December 31, 2020, were $5.49 billion and were 75.03% of total assets, compared to $5.09 billion and 76.79% of total assets at December 31, 2019. Average loans and leases, net of unearned discount, increased $463.28 million or 9.27% and increased $244.91 million or 5.15% in 2020 and 2019, respectively. PPP loans, net of unearned discount, at December 31, 2020 were $351.56 million and were located in the Commercial and agricultural lending portfolio.

Commercial and agricultural lending, excluding those loans secured by real estate but including PPP loans, increased $345.93 million or 30.54% in 2020 over 2019. Commercial and agricultural lending outstandings were $1.48 billion and $1.13 billion at December 31, 2020 and December 31, 2019, respectively. Most of the 2020 growth was attributed to PPP loans provided to our existing clients. Excluding PPP loans, commercial and agricultural lending outstandings were essentially flat in 2020 as business borrowers generally adopted a more conservative outlook, resulting in conserving cash and reducing borrowings. These reductions were mostly offset by increases within our solar loan and lease portfolio, which grew by $129.01 million or 78.86% to $292.60 million as that business line has continued to have positive momentum. We expect that momentum to continue into 2021.

Auto and light truck loans decreased $46.44 million or 7.89% in 2020 over 2019. At December 31, 2020, auto and light truck loans had outstandings of $542.37 million and $588.81 million at December 31, 2019. This decrease was primarily attributable to original equipment manufacturer (OEM) cancellations of new vehicles allocated to the auto rental industry due to the pandemic impact on business and sharply reduced leisure travel from the COVID-19 pandemic, and borrowers cancelled orders in the Spring and aggressively reduced fleet sizes given the strong used car market. Additionally, the cancellation of leisure and business events and travel restrictions had a negative impact on our bus customers. These negatives were offset by strong work truck sales to customers in the logistics space.

Medium and heavy duty truck loans and leases decreased $15.65 million or 5.31% in 2020. Medium and heavy duty truck financing at December 31, 2020 and 2019 had outstandings of $279.17 million and $294.82 million, respectively. The decrease at December 31, 2020 from December 31, 2019 can be mainly attributed to normal runoff of loans and leases that were not replaced due to pricing discipline.

Aircraft financing at year-end 2020 increased $77.42 million or 9.87% from year-end 2019. Aircraft financing at December 31, 2020 and 2019 had outstandings of $861.46 million and $784.04 million, respectively. The increase during 2020 was due to higher domestic outstandings of $81.60 million offset by lower foreign outstandings of $4.18 million. Our 2020 originations increased as demand was bolstered by a greater acceptance of business jets as a safe and efficient alternative to commercial air travel during the COVID-19 pandemic, drawing a number of first time entrants to private aircraft ownership. Our foreign outstandings held relatively flat year over year. Our foreign loan and lease outstandings, all denominated in U.S. dollars were $180.06 million and $184.24 million as of December 31, 2020 and 2019, respectively. Loan and lease outstandings to borrowers in Brazil and Mexico were $66.98 million and $103.52 million as of December 31, 2020, respectively, compared to $58.29 million and $111.91 million as of December 31, 2019, respectively. Outstanding balances to other borrowers in other countries were insignificant.

Construction equipment financing increased $9.44 million or 1.34% in 2020 compared to 2019. Construction equipment financing at December 31, 2020 had outstandings of $714.89 million, compared to outstandings of $705.45 million at December 31, 2019. The growth in this category was primarily due to significant new client relationships.

Commercial loans secured by real estate, of which approximately 51% is owner occupied, increased $61.69 million or 6.79% in 2020 over 2019. Commercial loans secured by real estate outstanding at December 31, 2020 were $969.86 million and $908.18 million at December 31, 2019. The increase in 2020 was driven by modest growth of owner occupied borrowings, within certain business sectors of our markets. Our non-owner occupied real estate portfolio also experienced growth due to funding several projects to existing clients that had been in our pipeline. That growth was primarily within the commercial office/warehousing and the commercial, residential and multi-family segments.

Residential real estate and home equity loans were $511.38 million at December 31, 2020 and $532.00 million at December 31, 2019. Residential real estate and home equity loans decreased $20.62 million or 3.88% in 2020 from 2019. Residential mortgage and home equity outstandings were lower in 2020 due to favorable secondary market conditions. Many clients took advantage of low secondary market rates to lock in their payments versus the variable rates of home equity lines of credit.

Consumer loans decreased $7.99 million or 5.73% in 2020 over 2019. Consumer loans outstanding at December 31, 2020, were $131.45 million and $139.43 million at December 31, 2019. The decrease during 2020 was primarily due to a variety of market factors. Many clients were hesitant to borrow as uncertainty lingered with the COVID-19 pandemic. In addition, because of initial declines in sales, many automobile manufacturers offered zero percent, or close to, financing options. Finally, we saw a decrease in applications for unsecured loans in 2020 compared to 2019.

The following table shows the maturities of loans and leases in the categories of commercial and agricultural, auto and light truck, medium and heavy duty truck, aircraft and construction equipment outstanding as of December 31, 2020.

(Dollars in thousands)	0-1 Year	1-5 Years	Over 5 Years	Total
Commercial and agricultural	$ 823,906	$ 543,380	$ 111,436	$ 1,478,722
Auto and light truck	187,374	318,387	36,608	542,369
Medium and heavy duty truck	97,548	176,585	5,039	279,172
Aircraft	182,386	617,589	61,485	861,460
Construction equipment	198,583	483,235	33,070	714,888
Commercial real estate	148,108	529,976	291,780	969,864
Residential real estate and home equity	136,777	246,499	128,103	511,379
Consumer	67,450	63,485	512	131,447
Total	**$ 1,842,132**	**$ 2,979,136**	**$ 668,033**	**$ 5,489,301**

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

Rate Sensitivity *(Dollars in thousands)*	Fixed Rate	Variable Rate	Total
1 – 5 Years	$ 2,184,711	$ 794,425	$ 2,979,136
Over 5 Years	222,318	445,715	668,033
Total	**$ 2,407,029**	**$ 1,240,140**	**$ 3,647,169**

During 2020, approximately 69% of the Bank's residential mortgage originations were sold into the secondary market. Mortgage loans held for sale were $12.89 million at December 31, 2020 and were $20.28 million at December 31, 2019.

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

Our liability for repurchases, included in Accrued Expenses and Other Liabilities on the Statements of Financial Condition, was $0.33 million and $0.29 million as of December 31, 2020 and 2019, respectively. Our expense (recovery) for repurchase losses, included in Loan and Lease Collection and Repossession expense on the Statements of Income, was $0.03 million in 2020 compared to $0.01 million in 2019 and $(0.10) million in 2018. The mortgage repurchase liability represents our best estimate of the loss that we may incur. The estimate is based on specific loan repurchase requests and a historical loss ratio with respect to origination dollar volume. Because the level of mortgage loan repurchase losses is dependent on economic factors, investor demand strategies and other external conditions that may change over the life of the underlying loans, the level of liability for mortgage loan repurchase losses is difficult to estimate and requires considerable management judgment.

CREDIT EXPERIENCE

Allowance for Credit Losses — As of December 31, 2020, we adopted ASU 2016-13 Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, as amended, which replaces the incurred loss methodology with an expected loss methodology that is referred to as current expected credit losses (CECL) methodology. The allowance for loan and lease losses considers the historical loss experience, current conditions, and reasonable and supportable forecasts. To estimate expected loan and lease losses under CECL, we used a broader range of data than under previous U.S. generally accepted accounting principles. We were able to access loan data over a long-time horizon, generally back to Q4 2007, thus capturing most of the economic business cycle which includes the Great Recession and the subsequent long slow recovery which supports full lifetime losses. The CECL methodology requires our loan portfolio to be segregated into pools based on similar risk characteristics. We evaluated each portfolio, establishing numerous segments. We then reviewed risk characteristics for each segment, noting that some pools were either too small for meaningful analysis or contained risk characteristics similar to other pools. Thus some pools were consolidated.

Loans and leases within each pool are collectively evaluated using either the cohort cumulative loss rate methodology or the probability of default (PD)/loss given default (LGD) methodology with transition matrix PD/historical average LGD. Our management evaluates the allowance quarterly, reviewing all loans and leases over a fixed-dollar amount ($100,000) where the internal credit quality grade is at or below a predetermined classification, actual and anticipated loss experience, current economic events in specific industries, and other pertinent factors including general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates and adjustments to historical loss rates to capture differences that may exist between the current and historical conditions, including consideration of environmental factors, principally economic risk which is generally reflected in forecast adjustments, specific industry risk and concentration risk, all of which may be susceptible to significant and unforeseen changes. We review the status of the loan and lease portfolio to identify borrowers that might develop financial problems in order to aid borrowers in the handling of their accounts and to mitigate losses. Our allowance for loan and lease losses is provided for by direct charges to the provision for credit losses. Losses on loans and leases are charged against the allowance and likewise, recoveries during the period for prior losses are credited to the allowance. Because business processes and credit risks associated with unfunded credit commitments are essentially the same as for loans, we utilize similar processes to estimate our liability for unfunded credit commitments. Our allowance for unfunded credit commitments is located in Accrued Expenses and Other Liabilities on the Consolidated Statements of Financial Position and is provided by direct charges to the provision for unfunded credit commitments located in Other Noninterest Expense on the Consolidated Statements of Income. See Part II, Item 8, Financial Statements and Supplementary Data — Note 1 of the Notes to Consolidated Financial Statements for additional information on management's evaluation of the allowance for credit losses.

We perform a thorough analysis of charge-offs, non-performing asset levels, special attention outstandings and delinquency in order to review portfolio trends, including specific industry risks and economic conditions, which may have an impact on the allowance and allowance ratios applied to various portfolios. We adjust the calculated historical based ratio as a result of our analysis of environmental factors, principally specific industry risk, collateral risk and concentration risk, in addition to global economic and political issues. We also have a forecast adjustment that includes key economic factors affecting our portfolios such as growth in gross domestic product, unemployment rates, housing market trends, commodity prices, and inflation. Forecast adjustments were difficult to establish due to unprecedented uncertainty given the national emergency due to the pandemic, the worldwide resurgence of COVID-19 and the tumultuous political landscape. Patterns from our history of business cycles, particularly the Great Recession of 2008, are not particularly relevant due to the extraordinary monetary and fiscal stimulus provided by the U.S. government and the Federal Reserve. Nonetheless, recent indicators have been discouraging with high unemployment and jobless claims ticking up, signaling the economy may again be stalling. The current political turmoil, impeachment concerns and ongoing strife in the Middle East, cause increased uncertainty. Collateral values are significant to underwriting our specialty finance portfolios and volatility or declining values pose a threat. Concentration risk is impacted primarily by geographic concentration in Northern Indiana and Southwestern Michigan in our business banking and commercial real estate portfolios and by collateral concentration in our specialty finance portfolios.

World economies are generally in a recession due to the pandemic and challenges persist. Current concerns include ongoing tariff wars, high numbers of COVID-19 cases, corruption scandals and political uncertainty in Latin American countries, particularly Brazil and Mexico where we have a presence with our aircraft lending, the competitive and complex nature of U.S.-China relations, the geopolitical tensions with Russia, and the persistent threats of terrorist attacks. We include a factor in our qualitative adjustments for global risk, as we are increasingly aware of the threat that global concerns may affect our customers. While we are unable to determine with any precision the impact of global economic and political issues on 1st Source Bank's loan and lease portfolios, we feel the risks are real and significant. We believe there is a risk of negative consequences for our borrowers that would affect their ability to repay their financial obligations. Therefore, we continue to include a factor for global risk in our analysis for 2020.

The following discussion focuses on relevant economic conditions and various circumstances impacting the December 31, 2020 allowance for loan and lease losses of each of our loan and lease segments.

Commercial and agricultural – There are several industries represented in the commercial and agricultural portfolio. This portfolio benefited from the monetary and fiscal stimulus, particularly the Paycheck Protection Program (PPP) loans. The outlook for the portfolio is guarded. We have some exposure to the hospitality industry, which continues to suffer from low occupancy and reduced rates. Restaurants are barely getting by; those that were able to refocus on carry-out business are likely to be able to sustain operations and take advantage of stimulus funds. The recreational vehicle industry which is centered in our footprint is going strong and our customers engaged in manufacturing for and supplying to the industry are doing well. Consumer and small business confidence deteriorated in December, as the resurgence of COVID-19 remains a drag on confidence. Our entry into solar financing over four years ago continues to look promising and gain momentum in terms of performance of existing projects financed, loan growth opportunities and overall credit quality. The outlook for our agricultural portfolio has improved with stronger commodity prices, particularly for corn and beans, and with projected higher incomes for farmers after five years of decline. Our customers have had favorable growing conditions which have resulted in strong crop yields. In the commercial and agricultural portfolio, we have experienced stable credit quality trends with low delinquencies and minimal charge-offs. We reviewed the historical loss ratios and assessed the environmental factors and concentration issues affecting these portfolios and believe the qualitative adjustments we made to our allowance ratios are appropriate and adequate.

Auto and light truck – Our auto and light truck portfolio was immediately impacted by the national emergency caused by the pandemic and subsequent shutdowns, shelter in place and social distancing mandates. Numerous customers requested deferrals, either principal and interest skips or interest only modifications. The auto rental industry had the advantage of a strong used car market; thus, customers were able to reduce their fleets at reasonable values. For some van rental customers, the situation was different as low roof passenger vans experienced reduced demand with social distancing concerns. The losses in the portfolio were concentrated in the bus sector as several accounts were placed in non-accrual status and included several write-downs. We increased our COVID-19 related qualitative adjustments for the bus segment each quarter through year-end. Our CECL methodology captures the movement from the grade 1-6 risk rated pool to the grade 7-12 special attention pool and the current losses; however, we believe the remaining credit risk in the portfolio to be more consistent with our 2020 experience than what is reflected in the historical loss ratio, thus we increased our qualitative adjustments as we more fully realized the severity and duration of the situation. The auto rental portion of the portfolio continues to be threatened by ongoing consolidation in the rental car industry which remains a threat to portfolio growth. On the other hand, collateral values have been relatively stable. We did add a qualitative adjustment for COVID-19 impacts, but a significantly lesser adjustment than for the bus segment.

Medium and heavy duty truck – We experienced ongoing stability in the medium and heavy duty truck portfolio. We recognized sizable losses during 2009 and the first half of 2010; however, since then we have had only two charge-offs, one small account in 2018 and a mid-sized credit in 2019. The industry experienced revenue decreases in 2020 due to COVID-19 job losses, declining trade volumes and oil price declines eliminating surcharges. However, the situation improved in the latter half of the year, buoyed by e-commerce and a robust residential housing market, closing the year on an ongoing upswing with December tonnage showing increases month-over-month and year-over-year. The prospects for an improved 2021 are strong with anticipated GDP growth, stimulus funds coming from the Coronavirus Response and Relief Supplemental Appropriations Act and the potential for additional stimulus from the $1.9 trillion pandemic relief package proposed by the new president. Truck chassis sales were expected to experience a cyclical decline in 2020, which they did and to a greater extent than projected due to the pandemic. There are clear indications for a sales resurgence in 2021, potentially enhancing loan growth opportunities in this portfolio, although interest rate pressures continue. We believe our reserve ratios for this portfolio are appropriate.

Aircraft – Another area of concern continues to be our aircraft portfolio, which was among the sectors affected most by the sluggish economy following the Great Recession. This sector was immediately impacted by COVID-19 related shutdowns, the ongoing impact of which was disparate depending on our borrowers' business focus. Tourism came to an abrupt halt and has not come back due to social distancing requirements. Business travel is down. Private jet providers appeal to a segment of the market that wishes to either minimize exposure to COVID-19 or avoid the hassles of contending with disrupted airline schedules. Cargo carriers were initially negatively impacted but are seeing improvement with increased movement of goods. In this portfolio we also have $180 million of foreign exposure, primarily in Mexico and Brazil. Both Mexico and Brazil are suffering recessionary impacts from COVID-19. The Mexican economy had contracted prior to the pandemic shock. Manufacturing registered a significant decline at the outset of the pandemic but is recovering due to economic activity picking up in the U.S. and normalization of trade relations with the U.S. Mexico's economic growth is hindered by a lack of significant fiscal relief measures. Furthermore, growth continues to be threatened by drug trafficking and related violence. Brazil's economic recovery was interrupted by the pandemic as GDP plunged in the second quarter of 2020. However, the rebound during the third quarter portends well for continued improvement into 2021, tempered by uncertainties in the global economy. The slowed U.S. economic growth and significantly reduced business travel presents headwinds for the business aviation industry. Collateral values seem to be holding so far, except for older models. Our historical loss ratios reflect our high and volatile loss histories. Accordingly, we adjusted the historical ratios for current conditions, principally uncertainty and, to a lesser extent, collateral concerns, and believe they are appropriate.

Construction equipment – Our construction equipment portfolio historically has been characterized by stable credit quality; however, we have some exposure to mining and frac sand and these sectors have not performed well, resulting in increased special attention outstandings, non-accrual loans and a sizable charge-off in this portfolio in 2020. The construction industry benefited from growth in private residential construction and a lesser impact of COVID-19 related shutdowns than many industries. Nonetheless, certain sectors are experiencing stress and we continue to monitor for credit weaknesses. Historically, 1st Source has experienced less volatility in this portfolio than the industry as losses have been mitigated by appropriate underwriting and a global market for used construction equipment. The potential continued infrastructure spending as we emerge from this recession could have a positive impact for the industry used equipment markets. The underlying risk has not changed significantly for most segments in this portfolio; our qualitative adjustments are similar to last year.

Commercial real estate – Similar to the commercial portfolio, our commercial real estate loans are concentrated in our local market with local customers, with approximately fifty-one percent of the Bank's exposure being owner occupied facilities where we are the primary relationship bank for our customers. Nevertheless, we were not immune to the dramatic declines in real estate values following the Great Recession of 2008, similar to other U.S. markets and we experienced losses in these categories from 2009 through 2011. From 2012 through 2020, we have experienced small recoveries in the portfolio with the exception of 2018 when we realized a small loss. We reviewed our qualitative adjustments and believe they are appropriate and adequate this year-end.

Residential real estate and home equity – Our residential real estate and home equity portfolio consists of loans to individuals in the communities we serve. Generally, residential mortgage loans are originated using standards that result in salable mortgages. Home equity loans are also advanced in compliance with regulatory guidelines and the Bank's credit policy. Losses in these portfolios have been miniscule since 2013, but we did experience losses during the housing crises. We reviewed our qualitative adjustments, which are primarily for reasonable and supportable forecasts, and believe they are appropriate and adequate.

Consumer – Our consumer loan portfolio consists of loans to individuals in the communities we serve. This portfolio consists primarily of loans secured by autos with advances in compliance with the Bank's underwriting standards. Losses are stable during good economic times and tend to tick up when there is deterioration in local economic factors and employment rates. We reviewed our qualitative adjustments, which are primarily for reasonable and supportable forecasts, and believe they are appropriate.

The allowance for loan and lease losses at December 31, 2020, totaled $140.65 million and was 2.56% of loans and leases, compared to $111.25 million or 2.19% of loans and leases at December 31, 2019 and $100.47 million or 2.08% of loans and leases at December 31, 2018. Our Day 1 adjustment as of January 1, 2020 for CECL adoption was an increase to the allowance for loan and lease losses of $2.58 million and $0.78 million for the unfunded loan commitments liability. It is our opinion that the allowance for loan and lease losses was appropriate to absorb current expected credit losses inherent in the loan and lease portfolio as of December 31, 2020.

Charge-offs for loan and lease losses were $13.97 million for 2020, compared to $7.59 million for 2019 and $17.11 million for 2018. We had one notable loss in the construction equipment portfolio, one in the auto rental segment of the auto and light truck portfolio and several small losses which were sizeable when aggregated in the bus segment of the auto and light truck portfolio. The provision for credit losses was $36.00 million for 2020, compared to $15.83 million for 2019 and $19.46 million for 2018 to accommodate net charge-offs, loan and lease growth and, for 2020, increased credit risk due to the pandemic.

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

(Dollars in thousands)	**2020**	2019	2018	2017	2016
Amounts of loans and leases outstanding at end of period	**$5,489,301**	$ 5,085,527	$ 4,835,464	$ 4,527,678	$ 4,188,071
Average amount of net loans and leases outstanding during period	**$5,463,436**	$ 5,000,161	$ 4,755,256	$ 4,333,375	$ 4,113,508
Balance of allowance for loan and lease losses at beginning of period	**$ 111,254**	$ 100,469	$ 94,883	$ 88,543	$ 88,112
Impact from adoption of ASC 326	**2,584**	—	—	—	—
Adjusted balance of allowance for loan and lease losses at beginning of period	**113,838**	100,469	94,883	88,543	88,112
Charge-offs:					
Commercial and agricultural	**903**	1,040	229	2,415	547
Auto and light truck	**7,107**	991	3,308	774	4
Medium and heavy duty truck	**15**	1,132	23	—	—
Aircraft	**855**	3,066	12,222	1,872	6,123
Construction equipment	**4,090**	238	288	164	128
Commercial real estate	**37**	5	70	344	32
Residential real estate and home equity	**74**	53	63	124	219
Consumer	**893**	1,066	909	836	888
Total charge-offs	**13,974**	7,591	17,112	6,529	7,941
Recoveries:					
Commercial and agricultural	**663**	664	222	984	509
Auto and light truck	**499**	97	68	1,153	253
Medium and heavy duty truck	**18**	32	—	—	10
Aircraft	**1,800**	1,143	2,499	227	528
Construction equipment	**1,415**	160	100	298	461
Commercial real estate	**58**	75	53	851	469
Residential real estate and home equity	**33**	85	23	109	31
Consumer	**303**	287	271	267	278
Total recoveries	**4,789**	2,543	3,236	3,889	2,539
Net charge-offs (recoveries)	**9,185**	5,048	13,876	2,640	5,402
Provision for loan and lease losses	**36,001**	15,833	19,462	8,980	5,833
Balance at end of period	**$ 140,654**	$ 111,254	$ 100,469	$ 94,883	$ 88,543
Ratio of net charge-offs (recoveries) to average net loans and leases outstanding	**0.17 %**	0.10 %	0.29 %	0.06 %	0.13 %
Ratio of allowance for loan and lease losses to net loans and leases outstanding end of period	**2.56 %**	2.19 %	2.08 %	2.10 %	2.11 %
Coverage ratio of allowance for loan and lease losses to nonperforming loans and leases	**232.47 %**	1,101.74 %	355.96 %	477.66 %	435.68 %

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

	2020	2019	2018	2017	2016
Commercial and agricultural	**0.02 %**	0.03 %	— %	0.16 %	— %
Auto and light truck	**1.18**	0.15	0.60	(0.08)	(0.06)
Medium and heavy duty truck	**—**	0.38	0.01	—	—
Aircraft	**(0.12)**	0.24	1.15	0.21	0.69
Construction equipment	**0.37**	0.01	0.03	(0.03)	(0.07)
Commercial real estate	**—**	(0.01)	—	(0.07)	(0.06)
Residential real estate and home equity	**0.01**	(0.01)	0.01	—	0.04
Consumer	**0.43**	0.57	0.48	0.44	0.49
Total net charge-offs (recoveries) to average portfolio loans and leases	**0.17 %**	0.10 %	0.29 %	0.06 %	0.13 %

The allowance for loan and lease losses has been allocated according to the amount deemed necessary to provide for the estimated current expected credit losses. The following table shows the amount of such components of the allowance for loan and lease losses at December 31 and the ratio of such loan and lease categories to total outstanding loan and lease balances.

	2020		2019		2018		2017		2016	
(Dollars in thousands)	**Allowance Amount**	**Percentage of Loans and Leases in Each Category to Total Loans and Leases**	Allowance Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases	Allowance Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases	Allowance Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases	Allowance Amount	Percentage of Loans and Leases in Each Category to Total Loans and Leases
Commercial and agricultural	**$ 22,229**	**26.94 %**	$ 23,671	22.27 %	$ 17,063	22.20 %	$ 16,228	20.54 %	$ 14,668	19.40 %
Auto and light truck	**28,926**	**9.88**	14,400	11.58	14,689	11.58	10,103	10.97	8,064	9.83
Medium and heavy duty truck	**6,400**	**5.09**	4,612	5.80	4,303	5.86	4,844	6.56	4,740	7.04
Aircraft	**34,053**	**15.69**	31,058	15.42	33,047	16.61	34,619	18.66	34,352	19.16
Construction equipment	**19,166**	**13.02**	14,120	13.87	10,922	13.34	9,343	12.44	8,207	11.84
Commercial real estate	**22,758**	**17.67**	18,350	17.86	15,705	16.75	14,792	16.38	13,677	17.17
Residential real estate and home equity	**5,374**	**9.32**	3,609	10.46	3,425	10.83	3,666	11.62	3,550	12.46
Consumer	**1,748**	**2.39**	1,434	2.74	1,315	2.83	1,288	2.83	1,285	3.10
Total	**$ 140,654**	**100.00 %**	$ 111,254	100.00 %	$ 100,469	100.00 %	$ 94,883	100.00 %	$ 88,543	100.00 %

Nonperforming Assets — Nonperforming assets include loans past due over 90 days, nonaccrual loans and leases, other real estate, repossessions and other nonperforming assets we own. Our policy is to discontinue the accrual of interest on loans and leases where principal or interest is past due and remains unpaid for 90 days or more, or when an individual analysis of a borrower's credit worthiness indicates a credit should be placed on nonperforming status, except for residential real estate and home equity loans, which are placed on nonaccrual at the time the loan is placed in foreclosure and consumer loans that are both well secured and in the process of collection.

Nonperforming assets amounted to $64.53 million at December 31, 2020, compared to $19.24 million at December 31, 2019, and $35.32 million at December 31, 2018. During 2020, interest income on nonaccrual loans and leases would have increased by approximately $3.49 million compared to $0.69 million in 2019 if these loans and leases had earned interest at their full contractual rate.

Nonperforming assets at December 31, 2020 increased from December 31, 2019, mainly due to increases in nonaccrual loans and leases offset by decreases in repossessions. Repossessions consisted mainly of charter buses which are included in our auto and light truck portfolio. Other real estate decreased due to sales of existing properties outpacing foreclosures.

Nonperforming assets at December 31 ***(Dollars in thousands)***	**2020**	2019	2018	2017	2016
Loans past due over 90 days	**$ 115**	$ 309	$ 366	$ 459	$ 416
Nonaccrual loans and leases:					
Commercial and agricultural	**5,933**	969	2,653	2,603	3,981
Auto and light truck	**36,945**	1,250	11,374	8,041	166
Medium and heavy duty truck	**720**	1,074	106	371	—
Aircraft	**828**	875	7,561	1,957	6,110
Construction equipment	**12,373**	1,351	2,326	991	1,248
Commercial real estate	**1,494**	1,652	1,984	3,418	5,555
Residential real estate and home equity	**1,718**	2,189	1,714	1,890	2,641
Consumer	**377**	429	141	134	206
Total nonaccrual loans and leases	**60,388**	9,789	27,859	19,405	19,907
Total nonperforming loans and leases	**60,503**	10,098	28,225	19,864	20,323
Other real estate	**359**	522	299	1,312	704
Repossessions:					
Commercial and agricultural	**—**	—	—	—	—
Auto and light truck	**1,120**	1,865	440	165	32
Medium and heavy duty truck	**—**	—	15	—	—
Aircraft	**750**	6,707	6,209	9,335	9,335
Construction equipment	**—**	35	—	582	—
Consumer	**106**	16	2	32	6
Total repossessions	**1,976**	8,623	6,666	10,114	9,373
Operating leases	**1,695**	—	126	9	34
Total nonperforming assets	**$ 64,533**	$ 19,243	$ 35,316	$ 31,299	$ 30,434
Nonperforming loans and leases to loans and leases, net of unearned discount	**1.11 %**	0.20 %	0.58 %	0.44 %	0.49 %
Nonperforming assets to loans and leases and operating leases, net of unearned discount	**1.16 %**	0.37 %	0.71 %	0.67 %	0.70 %

Potential Problem Loans — Potential problem loans consist of loans that are performing but for which management has concerns about the ability of a borrower to continue to comply with repayment terms because of the borrower's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. As of December 31, 2020 and 2019, we had $16.60 million and $17.74 million, respectively, in loans of this type which are not included in either of the non-accrual or 90 days past due loan categories. At December 31, 2020, potential problem loans consisted of six credit relationships two of which are bus accounts and one of which is a hotel. The other three relationships are without any commonalities with regard to industry or collateral. Weakness in these companies' operating performance and payment patterns have caused us to heighten attention given to these credits.

INVESTMENT PORTFOLIO

The amortized cost of securities at year-end 2020 increased 13.49% from 2019, following a 2.95% increase from year-end 2018 to year-end 2019. The amortized cost of securities at December 31, 2020 was $1.17 billion or 16.04% of total assets, compared to $1.03 billion or 15.61% of total assets at December 31, 2019.

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

(Dollars in thousands)	**2020**	2019	2018
U.S. Treasury and Federal agencies securities	**$ 610,195**	$ 524,896	$ 537,913
U.S. States and political subdivisions securities	**78,812**	83,566	95,346
Mortgage-backed securities — Federal agencies	**442,748**	372,458	324,390
Corporate debt securities	**40,813**	52,151	45,843
Foreign government securities	**700**	700	700
Total investment securities available-for-sale	**$ 1,173,268**	$ 1,033,771	$ 1,004,192

Yields on tax-exempt obligations are calculated on a fully tax-equivalent basis assuming a 21% tax rate. The following table shows the maturities of securities available-for-sale at December 31, 2020, at the amortized costs and weighted average yields of such securities.

(Dollars in thousands)	Amount	Yield
U.S. Treasury and Federal agencies securities		
Under 1 year	$ 86,637	1.99 %
1 – 5 years	448,891	1.18
5 – 10 years	74,667	0.68
Over 10 years	—	—
Total U.S. Treasury and Federal agencies securities	**610,195**	**1.23**
U.S. States and political subdivisions securities		
Under 1 year	15,699	2.61
1 – 5 years	47,832	2.31
5 – 10 years	14,701	1.07
Over 10 years	580	2.79
Total U.S. States and political subdivisions securities	**78,812**	**2.14**
Corporate debt securities		
Under 1 year	13,019	2.06
1 – 5 years	27,794	2.74
5 – 10 years	—	—
Over 10 years	—	—
Total Corporate debt securities	**40,813**	**2.52**
Foreign government securities		
Under 1 year	200	3.47
1 – 5 years	500	2.34
5 – 10 years	—	—
Over 10 years	—	—
Total Foreign government securities	**700**	**2.66**
Mortgage-backed securities — Federal agencies	**442,748**	**1.86**
Total investment securities available-for-sale	**$ 1,173,268**	**1.58 %**

At December 31, 2020, the residential mortgage-backed securities we held consisted of GNMA, FNMA and FHLMC pass-through certificates (Government Sponsored Enterprise, GSEs). The type of loans underlying the securities were all conforming loans at the time of issuance. The underlying GSEs backing these mortgage-backed securities are rated Aaa or AA+ from the rating agencies. At December 31, 2020, the vintage (years originated) of the underlying loans comprising our securities are: 43% in the year 2020; 25% in the years 2018 and 2019; 17% in the years 2016 and 2017; 3% in the years 2014 and 2015; and 12% in years 2013 and prior.

DEPOSITS

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

	2020		2019		2018	
(Dollars in thousands)	**Amount**	**Rate**	Amount	Rate	Amount	Rate
Noninterest bearing demand	**$ 1,530,698**	**— %**	$ 1,171,639	— %	$ 1,069,664	— %
Interest bearing demand	**1,827,673**	**0.24**	1,635,209	0.82	1,610,022	0.62
Savings	**926,585**	**0.11**	825,292	0.20	839,652	0.14
Time	**1,451,646**	**1.73**	1,644,596	2.16	1,444,325	1.63
Total deposits	**$ 5,736,602**		$ 5,276,736		$ 4,963,663	

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

SHORT-TERM BORROWINGS

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

(Dollars in thousands)	Federal Funds Purchased and Securities Repurchase Agreements	Commercial Paper	Federal Home Loan Bank Advances	Other Short-Term Borrowings	Total Borrowings
2020					
Balance at December 31, 2020	**$ 143,564**	**$ 4,766**	**$ —**	**$ 2,311**	**$ 150,641**
Maximum amount outstanding at any month-end	**226,473**	**5,068**	**141,000**	**2,643**	**375,184**
Average amount outstanding	**174,088**	**4,679**	**20,582**	**1,816**	**201,165**
Weighted average interest rate during the year	**0.19 %**	**0.23 %**	**0.87 %**	**— %**	**0.26 %**
Weighted average interest rate for outstanding amounts at December 31, 2020	**0.08 %**	**0.13 %**	**N/A**	**— %**	**0.08 %**
2019					
Balance at December 31, 2019	$ 120,459	$ 3,993	$ 20,000	$ 1,441	$ 145,893
Maximum amount outstanding at any month-end	187,848	4,820	168,000	1,762	362,430
Average amount outstanding	143,625	4,547	56,326	1,413	205,911
Weighted average interest rate during the year	0.33 %	0.28 %	2.56 %	— %	0.94 %
Weighted average interest rate for outstanding amounts at December 31, 2019	0.23 %	0.29 %	1.61 %	— %	0.42 %
2018					
Balance at December 31, 2018	$ 113,627	$ 4,325	$ 80,000	$ 1,392	$ 199,344
Maximum amount outstanding at any month-end	148,002	5,590	225,000	2,740	381,332
Average amount outstanding	135,670	4,805	122,592	1,974	265,041
Weighted average interest rate during the year	0.30 %	0.29 %	1.97 %	— %	1.07 %
Weighted average interest rate for outstanding amounts at December 31, 2018	0.47 %	0.29 %	2.57 %	— %	1.30 %

LIQUIDITY AND CAPITAL RESOURCES

Core Deposits — Our major source of investable funds is provided by stable core deposits consisting of all interest bearing and noninterest bearing deposits, excluding brokered certificates of deposit, listing services certificates of deposit and certain certificates of deposit over $250,000 based on established FDIC insured deposits. In 2020, average core deposits equaled 73.64% of average total assets, compared to 71.48% in 2019 and 72.53% in 2018. The effective rate of core deposits in 2020 was 0.39%, compared to 0.77% in 2019 and 0.56% in 2018.

Average noninterest bearing core deposits increased 30.65% in 2020 compared to an increase of 9.53% in 2019. These represented 29.20% of total core deposits in 2020, compared to 25.11% in 2019, and 23.97% in 2018.

Purchased Funds — We use purchased funds to supplement core deposits, which include certain certificates of deposit over $250,000, brokered certificates of deposit, listing services certificates of deposit, over-night borrowings, securities sold under agreements to repurchase, commercial paper, and other short-term borrowings. Purchased funds are raised from customers seeking short-term investments and are used to manage the Bank’s interest rate sensitivity. During 2020, our reliance on purchased funds decreased to 9.76% of average total assets from 12.51% in 2019.

Shareholders’ Equity — Average shareholders’ equity equated to 12.15% of average total assets in 2020, compared to 12.25% in 2019. Shareholders’ equity was 12.12% of total assets at year-end 2020, compared to 12.51% at year-end 2019. We include unrealized gains (losses) on available-for-sale securities, net of income taxes, in accumulated other comprehensive income (loss) which is a component of shareholders’ equity. While regulatory capital adequacy ratios exclude unrealized gains (losses), it does impact our equity as reported in the audited financial statements. The unrealized gains on available-for-sale securities, net of income taxes, were $18.37 million and $5.17 million at December 31, 2020 and 2019, respectively.

Other Liquidity — Under Indiana law governing the collateralization of public fund deposits, the Indiana Board of Depositories determines which financial institutions are required to pledge collateral based on the strength of their financial ratings. We have been informed that no collateral is required for our public fund deposits. However, the Board of Depositories could alter this requirement in the future and adversely impact our liquidity. Our potential liquidity exposure if we must pledge collateral is approximately $797 million.

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

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

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

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

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

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

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

(iv) Loans to Deposits Ratio less than 100%

At December 31, 2020, we were in compliance with the foregoing internal policies and regulatory guidelines.

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

We have borrowing sources available to supplement deposits and meet our funding needs. 1st Source Bank has established relationships with several banks to provide short term borrowings in the form of federal funds purchased. At December 31, 2020, we borrowed zero in the federal funds market. We could borrow $245.00 million in additional funds for a short time from these banks on a collective basis. As of December 31, 2020, we had $55.18 million outstanding in FHLB advances and could borrow an additional $514.05 million contingent on the FHLB activity-based stock ownership requirement. We also had no outstandings with the FRB and could borrow $451.96 million as of December 31, 2020.

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

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

	Percentage Change in Net Interest Income			
	December 31, 2020		December 31, 2019	
Basis Point Interest Rate Change	**12 Months**	**24 Months**	12 Months	24 Months
Up 200	**0.18%**	**7.13%**	1.88%	5.57%
Up 100	**(0.23)%**	**3.46%**	0.95%	2.89%
Down 100	**(1.21)%**	**(2.30)%**	(4.06)%	(7.64)%

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

At December 31, 2020 and 2019, the impact of these hypothetical fluctuations in interest rates on our derivative holdings was not significant, and, as such, separate disclosure is not presented. We manage the interest rate risk related to mortgage loan commitments by entering into contracts for future delivery of loans with outside parties. See Part II, Item 8, Financial Statements and Supplementary Data — Note 18 of the Notes to Consolidated Financial Statements.

Commitments and Contractual Obligations — In the ordinary course of operations, we enter into certain contractual obligations. Such obligations include customer deposits, the funding of operations through debt issuances as well as operating leases for the rent of premises and equipment. Additionally, we routinely enter into contracts for services that may require payment to be provided in the future and may contain penalty clauses for early termination of the contract. Further discussion of commitments and contractual obligations is included in Part II, Item 8, Financial Statements and Supplementary Data — Notes 10, 11, 12 and 18 of the Notes to Consolidated Financial Statements.

We also enter into derivative contracts under which we are required to either receive cash from, or pay cash to, counterparties depending on changes in interest rates. Derivative contracts are carried at fair value on the consolidated balance sheet with the fair value representing the net present value of expected future cash receipts or payments based on market interest rates as of the balance sheet date. The fair value of the contracts changes daily as market interest rates change. Further discussion of derivative contracts is included in Part II, Item 8, Financial Statements and Supplementary Data — Note 19 of the Notes to Consolidated Financial Statements.

OFF-BALANCE SHEET ARRANGEMENTS

Assets under management and assets under custody are held in fiduciary or custodial capacity for our clients. In accordance with U.S. generally accepted accounting principles, these assets are not included on our balance sheet.

We are also party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our clients. These financial instruments include commitments to extend credit and standby letters of credit. Further discussion of these commitments is included in Part II, Item 8, Financial Statements and Supplementary Data — Note 18 of the Notes to Consolidated Financial Statements.

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth unaudited consolidated selected quarterly statement of operations data for the years ended December 31, 2020 and 2019.

Three Months Ended ***(Dollars in thousands, except per share amounts)***	**March 31**	**June 30**	**September 30**	**December 31**
2020				
Interest income	**$ 67,686**	**$ 63,850**	**$ 62,917**	**$ 68,578**
Interest expense	**12,842**	**9,849**	**8,049**	**6,471**
Net interest income	**54,844**	**54,001**	**54,868**	**62,107**
Provision for credit losses*	**11,353**	**10,375**	**9,303**	**4,970**
Gains (losses) on investment securities available-for-sale	**280**	**(1)**	**—**	**—**
Income before income taxes	**21,578**	**24,042**	**26,563**	**34,158**
Net income	**16,418**	**18,526**	**20,054**	**26,463**
Net income available to common shareholders	**16,413**	**18,502**	**20,058**	**26,464**
Diluted net income per common share	**0.64**	**0.72**	**0.78**	**1.03**
2019				
Interest income	$ 69,021	$ 71,637	$ 72,676	$ 69,543
Interest expense	14,073	15,210	15,481	14,247
Net interest income	54,948	56,427	57,195	55,296
Provision for loan and lease losses	4,918	4,247	3,717	2,951
Gains on investment securities available-for-sale	—	—	—	—
Income before income taxes	28,950	30,491	32,137	28,576
Net income	22,196	23,417	24,448	21,954
Net income available to common shareholders	22,196	23,385	24,438	21,941
Diluted net income per common share	0.86	0.91	0.95	0.86

*ASU 2016-13 adopted during the fourth quarter of 2020 with a cumulative effect adjustment dated January 1, 2020 therefore September 30, 2020, June 30, 2020, and March 31, 2020 provision amounts reflect the incurred loss calculation.

Net income available to common shareholders was $26.46 million for the fourth quarter of 2020, compared to the $21.94 million of net income available to common shareholders reported for the fourth quarter of 2019. Diluted net income per common share for the fourth quarter of 2020 amounted to $1.03, compared to $0.86 per common share reported in the fourth quarter of 2019.

Net interest margin was 3.54% for the fourth quarter of 2020 and 3.51% for the fourth quarter of 2019. Net interest income was $62.11 million for the fourth quarter of 2020 up 12.32% from 2019’s fourth quarter. Net interest margin on a fully taxable-equivalent basis was 3.55% for the fourth quarter of 2020 and 3.52% for the fourth quarter of 2019. Tax-equivalent net interest income was $62.23 million for the fourth quarter of 2020, up 12.22% from 2019’s fourth quarter.

Our provision for credit losses was $4.97 million in the fourth quarter of 2020 compared to $2.95 million in the fourth quarter of 2019. Net charge-offs were $3.72 million for the fourth quarter 2020, compared to net charge-offs of $0.64 million a year ago.

Noninterest income for the fourth quarter of 2020 was $25.99 million, compared to $25.58 million for the fourth quarter of 2019. Noninterest expense for the fourth quarter of 2020 was $48.96 million and was $49.35 million in the fourth quarter 2019.

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

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

Item 8. Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm

To the Shareholders, Board of Directors and Audit Committee
1st Source Corporation
South Bend, Indiana

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of financial condition of 1st Source Corporation (Company) as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively referred to as the "financial statements"). In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)* and our report dated February 18, 2021, expressed an unqualified opinion of the effectiveness of the Company's internal control over financial reporting.

Adoption of New Accounting Standard

As discussed in Notes 1, 4 and 5 to the consolidated financial statements, the Company has changed its method of accounting for the allowance for credit losses in 2020 due to the adoption of Topic 326. As discussed below, a component of the allowance for credit losses is considered a critical audit matter.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits.

We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below is a matter arising from the current-period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan and Lease Losses

As described in Note 5 to the consolidated financial statements, the Company's consolidated allowance for loan and lease losses (ALLL) was $140.65 million at December 31, 2020. The Company also describes in Note 1 of the consolidated financial statements the "Allowance for Loan and Lease Losses" accounting policy around this estimate. The ALLL is an estimate of current expected credit losses in the loan and lease portfolio. The determination of the allowance for loan and lease losses requires significant judgment reflecting the Company's best estimate of expected future losses for the loan's entire contractual term adjusted for expected payments when appropriate.

This assessment is made on a loan pool basis in most instances, with the expected credit losses estimates by using a combination of models that measures the probability of default, probability of attrition, loss given defaults and exposure at default. The assessments of probability of default and probability of attrition are based on internal data that relates to the historical performance of each loan pool over a complete economic cycle. Adjustments were then applied, if needed, to reflect the current impact of macroeconomic variables and to account for other expected changes that could occur in the future. These assumptions are analyzed for a reasonable and supportable forecast period, after which, the forecasted macroeconomic assumptions reverted to their historical average, using a rational and systematic basis. The loss given default is based on an analysis of historical recoveries for each loan pool, with adjustments to reflect the current impact of macroeconomic variables and to account for other expected changes that could occur in the future, if considered necessary. The exposure at default was estimated by using a transitional matrix that estimates the average percentage of the loan balance that remains at the time of default. Additional qualitative adjustments were applied in certain circumstances, to account for other factors not evaluated in the initial model. In certain instances, loans were evaluated on an individual basis due to the management's conclusion that they exhibited unique risk characteristics which prevented them from being similar to the identified loan pools.

The primary reason for our determination that the allowance for loan losses is a critical audit matter is that auditing the estimated allowance for loan losses involved significant judgment and high degree of subjectivity, due to the number of relevant assumptions and the nature of the qualitative factor adjustments. Additionally, there was high level of complexity involved in the implementation of ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. Areas that contained subjectivity in evaluating management's estimate, included evaluating management's assessment of current and expected economic conditions and other environmental factors, evaluating assumptions utilized in determining cohort loss rates, probability of default and loss given default, evaluating the adequacy of specific allowances associated with individually evaluated loans and assessing the appropriateness of loan grades.

Our audit procedures related to the estimated allowance for loan losses, both at initial adoption of ASU No. 2016-13 and at December 31, 2020, included:

- Testing the design and operating effectiveness of internal controls, including those related to technology, over the ALLL, the establishment of qualitative adjustments for current and expected conditions, grading and risk classification of loans and establishment of specific reserves on individually evaluated loans and management's review controls over the ALLL balance as a whole including attending internal Company Credit Policy Committee meetings and Audit Committee discussions and analysis.
- Testing clerical and computational accuracy of the formulas within the calculation.
- Testing of completeness and accuracy of the information and reports utilized in the ALLL, including reports used in management review controls over the ALLL.
- Evaluating the precision of management review of the adequacy of the ALLL.
- Evaluating the current and expected qualitative adjustments, including assessing the basis for the adjustments and the reasonableness of the significant assumptions including growth in gross domestic product, unemployment rates, housing market trends, commodity prices, and inflation rates.
- Evaluating the forecast adjustment, including assessing that it is reasonable and supportable.
- Evaluating significant assumptions utilized in the probability of default/loss given default model including probability of default run-out frequency, length, and look-back period and loss given default months of delay, look-back period and loss horizon.
- Evaluating significant assumptions utilized in the cohort model including look-back period, months of delay, and loss horizon.
- Evaluating the relevance and reliability of data and assumptions.
- Testing of the loan review function and the accuracy of loan grades determined. Specifically, utilizing internal professionals to assist us in evaluating the appropriateness of loan grades and to assess the reasonableness of specific impairments on loans.
- Evaluating the overall reasonableness of qualitative factors and the appropriateness of their direction and magnitude and the Company's support for the direction and magnitude compared to previous years.
- Evaluating credit quality indicators such as trends in delinquencies, nonaccruals, charge-offs, and loan grades.
- Identifying fields in the various loan systems that defined the loan pools and tested the design and operating effectiveness of internal controls surrounding the input and maintenance of those fields.

/s/ BKD, LLP

We have served as the Company's auditor since 2015

Fort Wayne, Indiana
February 18, 2021

Report of Independent Registered Public Accounting Firm

To the Shareholders, Board of Directors and Audit Committee
1st Source Corporation
South Bend, Indiana

Opinion on the Internal Control Over Financial Reporting

We have audited 1st Source Corporation's ("Company") internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control - Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).*

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control - Integrated Framework: (2013) issued by COSO*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States)("PCAOB"), the consolidated financial statements of the Company and our report dated February 18, 2021, expressed an unqualified opinion therein.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definitions and Limitations of Internal Control Over Financial Reporting

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

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

/s/ BKD, LLP

Fort Wayne, Indiana
February 18, 2021

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

December 31 *(Dollars in thousands)*	2020	2019
ASSETS		
Cash and due from banks	**$ 74,186**	$ 67,215
Federal funds sold and interest bearing deposits with other banks	**168,861**	16,150
Investment securities available-for-sale	**1,197,467**	1,040,583
Other investments	**27,429**	28,414
Mortgages held for sale	**12,885**	20,277
Loans and leases, net of unearned discount:		
Commercial and agricultural	**1,478,722**	1,132,791
Auto and light truck	**542,369**	588,807
Medium and heavy duty truck	**279,172**	294,824
Aircraft	**861,460**	784,040
Construction equipment	**714,888**	705,451
Commercial real estate	**969,864**	908,177
Residential real estate and home equity	**511,379**	532,003
Consumer	**131,447**	139,434
Total loans and leases	**5,489,301**	5,085,527
Allowance for loan and lease losses	**(140,654)**	(111,254)
Net loans and leases	**5,348,647**	4,974,273
Equipment owned under operating leases, net	**65,040**	111,684
Net premises and equipment	**49,373**	52,219
Goodwill and intangible assets	**83,948**	83,971
Accrued income and other assets	**288,575**	227,990
Total assets	**$ 7,316,411**	$ 6,622,776
LIABILITIES		
Deposits:		
Noninterest-bearing demand	**$ 1,636,684**	$ 1,216,834
Interest-bearing deposits:		
Interest-bearing demand	**2,059,139**	1,677,200
Savings	**1,082,848**	814,794
Time	**1,167,357**	1,648,498
Total interest-bearing deposits	**4,309,344**	4,140,492
Total deposits	**5,946,028**	5,357,326
Short-term borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	**143,564**	120,459
Other short-term borrowings	**7,077**	25,434
Total short-term borrowings	**150,641**	145,893
Long-term debt and mandatorily redeemable securities	**81,864**	71,639
Subordinated notes	**58,764**	58,764
Accrued expenses and other liabilities	**148,444**	140,518
Total liabilities	**6,385,741**	5,774,140
SHAREHOLDERS' EQUITY		
Preferred stock; no par value Authorized 10,000,000 shares; none issued or outstanding	—	—
Common stock; no par value Authorized 40,000,000 shares; issued 28,205,674 shares at December 31, 2020 and 2019	**436,538**	436,538
Retained earnings	**514,176**	463,269
Cost of common stock in treasury (2,816,557 shares at December 31, 2020 and 2,696,200 shares at December 31, 2019)	**(82,240)**	(76,702)
Accumulated other comprehensive income	**18,371**	5,172
Total shareholders' equity	**886,845**	828,277
Noncontrolling interests	**43,825**	20,359
Total equity	**930,670**	848,636
Total liabilities and equity	**$ 7,316,411**	$ 6,622,776

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

CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 ***(Dollars in thousands, except per share amounts)***	**2020**	2019	2018
Interest income:			
Loans and leases	**$ 242,772**	$ 258,348	$ 234,455
Investment securities, taxable	**18,080**	20,946	19,356
Investment securities, tax-exempt	**895**	1,351	1,857
Other	**1,284**	2,232	1,648
Total interest income	**263,031**	282,877	257,316
Interest expense:			
Deposits	**30,459**	50,495	34,631
Short-term borrowings	**517**	1,934	2,838
Subordinated notes	**3,367**	3,677	3,625
Long-term debt and mandatorily redeemable securities	**2,868**	2,905	2,316
Total interest expense	**37,211**	59,011	43,410
Net interest income	**225,820**	223,866	213,906
Provision for credit losses	**36,001**	15,833	19,462
Net interest income after provision for credit losses	**189,819**	208,033	194,444
Noninterest income:			
Trust and wealth advisory	**21,114**	20,692	21,071
Service charges on deposit accounts	**9,485**	11,010	10,454
Debit card	**14,983**	14,209	13,369
Mortgage banking	**15,674**	4,698	3,844
Insurance commissions	**7,025**	6,761	6,502
Equipment rental	**23,380**	30,741	31,793
Gains (losses) on investment securities available-for-sale	**279**	—	(345)
Other	**11,949**	13,019	10,362
Total noninterest income	**103,889**	101,130	97,050
Noninterest expense:			
Salaries and employee benefits	**101,556**	97,098	93,857
Net occupancy	**10,276**	10,528	10,041
Furniture and equipment	**25,688**	24,815	23,433
Depreciation — leased equipment	**20,203**	25,128	26,248
Professional fees	**6,317**	6,952	7,680
Supplies and communication	**5,563**	6,454	6,320
FDIC and other insurance	**2,606**	1,795	2,923
Business development and marketing	**4,157**	6,303	6,112
Loan and lease collection and repossession	**3,099**	3,402	3,375
Other	**7,902**	6,534	6,478
Total noninterest expense	**187,367**	189,009	186,467
Income before income taxes	**106,341**	120,154	105,027
Income tax expense	**24,880**	28,139	22,613
Net income	**81,461**	92,015	82,414
Net (income) loss attributable to noncontrolling interests	**(24)**	(55)	—
Net income available to common shareholders	**$ 81,437**	$ 91,960	$ 82,414
Basic net income per common share	**$ 3.17**	$ 3.57	$ 3.16
Diluted net income per common share	**$ 3.17**	$ 3.57	$ 3.16

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Year Ended December 31 ***(Dollars in thousands)***	**2020**	2019	2018
Net income	**$ 81,461**	$ 92,015	$ 82,414
Other comprehensive income (loss):			
Unrealized appreciation (depreciation) of investment securities available-for-sale	**17,666**	20,875	(9,073)
Reclassification adjustment for realized (gains) losses included in net income	**(279)**	—	345
Income tax effect	**(4,188)**	(5,027)	2,102
Other comprehensive income (loss), net of tax	**13,199**	15,848	(6,626)
Comprehensive income	**94,660**	107,863	75,788
Comprehensive (income) loss attributable to noncontrolling interests	**(24)**	(55)	—
Comprehensive income available to common shareholders	**$ 94,636**	$ 107,808	$ 75,788

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	1st Source Corporation Shareholders							
(Dollars in thousands, except per share amounts)	**Preferred Stock**	**Common Stock**	**Retained Earnings**	**Cost of Common Stock in Treasury**	**Accumulated Other Comprehensive Income (Loss), Net**	**Total Shareholders' Equity**	**Noncontrolling Interests**	**Total Equity**
Balance at January 1, 2018	$ —	$ 436,538	$ 339,959	$ (54,628)	$ (3,332)	$ 718,537	$ —	$ 718,537
Cumulative-effect adjustment	—	—	718	—	(718)	—	—	—
Balance at January 1, 2018, adjusted	—	436,538	340,677	(54,628)	(4,050)	718,537	—	718,537
Net income	—	—	82,414	—	—	82,414	—	82,414
Other comprehensive loss	—	—	—	—	(6,626)	(6,626)	—	(6,626)
Issuance of 47,977 common shares under stock based compensation awards	—	—	841	1,139	—	1,980	—	1,980
Cost of 201,013 shares of common stock acquired for treasury	—	—	—	(9,271)	—	(9,271)	—	(9,271)
Common stock dividend ($0.96 per share)	—	—	(24,952)	—	—	(24,952)	—	(24,952)
Contributions from noncontrolling interests	—	—	—	—	—	—	1,508	1,508
Balance at December 31, 2018	$ —	$ 436,538	$ 398,980	$ (62,760)	$ (10,676)	$ 762,082	$ 1,508	$ 763,590
Cumulative-effect adjustment	—	—	(301)	—	—	(301)	—	(301)
Balance at January 1, 2019, adjusted	—	436,538	398,679	(62,760)	(10,676)	761,781	1,508	763,289
Net income	—	—	91,960	—	—	91,960	55	92,015
Other comprehensive income	—	—	—	—	15,848	15,848	—	15,848
Issuance of 51,533 common shares under stock based compensation awards	—	—	862	1,143	—	2,005	—	2,005
Cost of 325,787 shares of common stock acquired for treasury	—	—	—	(15,085)	—	(15,085)	—	(15,085)
Common stock dividend ($1.10 per share)	—	—	(28,232)	—	—	(28,232)	—	(28,232)
Contributions from noncontrolling interests	—	—	—	—	—	—	18,934	18,934
Distributions to noncontrolling interests	—	—	—	—	—	—	(138)	(138)
Balance at December 31, 2019	$ —	$ 436,538	$ 463,269	$ (76,702)	$ 5,172	$ 828,277	$ 20,359	$ 848,636
Cumulative-effect adjustment	—	—	(2,552)	—	—	(2,552)	—	(2,552)
Balance at January 1, 2020, adjusted	—	436,538	460,717	(76,702)	5,172	825,725	20,359	846,084
Net income	**—**	**—**	**81,437**	**—**	**—**	**81,437**	**24**	**81,461**
Other comprehensive income	**—**	**—**	**—**	**—**	**13,199**	**13,199**	**—**	**13,199**
Issuance of 46,089 common shares under stock based compensation awards	**—**	**—**	**962**	**877**	**—**	**1,839**	**—**	**1,839**
Cost of 166,446 shares of common stock acquired for treasury	**—**	**—**	**—**	**(6,415)**	**—**	**(6,415)**	**—**	**(6,415)**
Common stock dividend ($1.13 per share)	**—**	**—**	**(28,940)**	**—**	**—**	**(28,940)**	**—**	**(28,940)**
Contributions from noncontrolling interests	**—**	**—**	**—**	**—**	**—**	**—**	**24,098**	**24,098**
Distributions to noncontrolling interests	**—**	**—**	**—**	**—**	**—**	**—**	**(656)**	**(656)**
Balance at December 31, 2020	**$ —**	**$ 436,538**	**$ 514,176**	**$ (82,240)**	**$ 18,371**	**$ 886,845**	**$ 43,825**	**$ 930,670**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31 ***(Dollars in thousands)***	**2020**	2019	2018
Operating activities:			
Net income	**$ 81,461**	$ 92,015	$ 82,414
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for credit losses	**36,001**	15,833	19,462
Depreciation of premises and equipment	**5,673**	5,786	5,620
Depreciation of equipment owned and leased to others	**20,203**	25,128	26,248
Stock-based compensation	**3,293**	2,765	3,553
Amortization of investment securities premiums and accretion of discounts, net	**6,057**	4,014	3,477
Amortization of mortgage servicing rights	**2,361**	1,312	956
Mortgage servicing rights impairments	**812**	—	—
Amortization of right of use assets	**2,842**	3,046	—
Deferred income taxes	**(24,160)**	(5,730)	(550)
(Gains) losses on investment securities available-for-sale	**(279)**	—	345
Originations of loans held for sale, net of principal collected	**(330,990)**	(145,097)	(78,450)
Proceeds from the sales of loans held for sale	**351,337**	139,050	82,127
Net gains on sale of loans held for sale	**(12,955)**	(2,940)	(1,844)
Net gains on sale of other real estate and repossessions	**(138)**	(487)	(561)
Net gain on sale of premises and equipment	**—**	(1,251)	(128)
Change in interest receivable	**(1,117)**	(245)	(1,747)
Change in interest payable	**(9,923)**	4,968	2,997
Change in other assets	**12,782**	11,213	(7,048)
Change in other liabilities	**10,293**	13,492	21,884
Other	**940**	1,734	940
Net change in operating activities	**154,493**	164,606	159,695
Investing activities:			
Proceeds from sales of investment securities available-for-sale	**8,403**	—	11,392
Proceeds from maturities and paydowns of investment securities available-for-sale	**443,617**	317,295	145,167
Purchases of investment securities available-for-sale	**(597,296)**	(351,189)	(255,205)
Net change in partnership investments	**(54,981)**	(33,840)	(13,669)
Net change in other investments	**985**	(10)	(2,451)
Loans sold or participated to others	**17,462**	53,369	22,835
Proceeds from principal payments on direct finance leases	**54,771**	69,188	50,457
Net change in loans and leases	**(489,477)**	(392,475)	(405,961)
Net change in equipment owned under operating leases	**26,414**	(2,495)	(21,107)
Purchases of premises and equipment	**(2,850)**	(8,033)	(3,058)
Proceeds from disposal of premises and equipment	**23**	3,418	216
Proceeds from sales of other real estate and repossessions	**10,271**	10,855	13,433
Net change in investing activities	**(582,658)**	(333,917)	(457,951)

Financing activities:			
Net change in demand deposits and savings accounts	**1,069,843**	54,272	171,799
Net change in time deposits	**(481,141)**	180,732	197,793
Net change in short-term borrowings	**4,748**	(53,451)	(15,251)
Proceeds from issuance of long-term debt	**10,000**	—	—
Payments on long-term debt	**(2,905)**	(2,695)	(1,735)
Stock issued under stock purchase plans	**39**	49	145
Acquisition of treasury stock	**(6,415)**	(15,085)	(9,271)
Net change in noncontrolling interests	**23,442**	18,796	1,508
Cash dividends paid on common stock	**(29,764)**	(29,021)	(25,686)
Net change in financing activities	**587,847**	153,597	319,302
Net change in cash and cash equivalents	**159,682**	(15,714)	21,046
Cash and cash equivalents, beginning of year	**83,365**	99,079	78,033
Cash and cash equivalents, end of year	**$ 243,047**	$ 83,365	$ 99,079
Supplemental Information:			
Non-cash transactions:			
Loans transferred to other real estate and repossessions	**$ 4,317**	$ 14,807	$ 11,007
Common stock matching contribution to Employee Stock Ownership and Profit Sharing Plan	**622**	300	583
Right of use assets obtained in exchange for lease obligation	**2,612**	17,064	—
Cash paid for:			
Interest	**$ 47,134**	$ 54,043	$ 40,413
Income taxes	**13,461**	5,585	8,272

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Accounting Policies

1st Source Corporation is a bank holding company headquartered in South Bend, Indiana that provides, through its subsidiaries (collectively referred to as “1st Source” or “the Company”), a broad array of financial products and services. 1st Source Bank (“Bank”), its banking subsidiary, offers commercial and consumer banking services, trust and wealth advisory services, and insurance to individual and business clients in Indiana, Michigan and Florida. The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements.

Basis of Presentation — The financial statements consolidate 1st Source, its subsidiaries (principally the Bank) and any variable interest entities (“VIEs”) for which the Company has concluded it has significant involvement in and the ability to direct the activities that impact the entity’s economic performance. All significant intercompany balances and transactions have been eliminated. For purposes of the parent company only financial information presented in Note 22, investments in subsidiaries are carried at equity in the underlying net assets.

Use of Estimates in the Preparation of Financial Statements — Financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

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

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

Securities — Securities that the Company has the ability and positive intent to hold to maturity are classified as investment securities held-to-maturity. Held-to-maturity investment securities, when present, are carried at amortized cost. As of December 31, 2020 and 2019, the Company held no securities classified as held-to-maturity. Securities that may be sold in response to, or in anticipation of, changes in interest rates and resulting prepayment risk, or for other factors, are classified as available-for-sale and are carried at fair value. Unrealized gains and losses on debt securities are reported, net of applicable taxes, as a separate component of accumulated other comprehensive income (loss) in shareholders’ equity. Unrealized gains and losses on equity securities are reflected, net of applicable taxes, in earnings.

For available-for-sale securities in an unrealized loss position, the Company first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of these criteria regarding intent or requirement to sell is met, the security’s amortized cost basis is written down to fair value in Other Income on the Consolidated Statements of Income. For debt securities that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, nature of the security, the underlying collateral, and the financial condition of the issuer, among other factors. If this assessment indicates a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of the cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for available-for-sale securities losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for available-for-sale securities losses is recognized in other comprehensive income.

Changes in the allowance for available-for-sale securities are recorded as a component of credit loss expense. Losses are charged against the allowance for available-for-sale securities losses when management believes the uncollectibility of an available-for-sale security is confirmed or when either criteria regarding intent or requirement to sell is met.

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

Other investments consist of shares of Federal Home Loan Bank of Indianapolis (FHLBI) and Federal Reserve Bank stock. As restricted member stocks, these investments are carried at cost. Both cash and stock dividends received on the stocks are reported as income. Quarterly, the Company reviews its investment in FHLBI for impairment. Factors considered in determining impairment are: history of dividend payments; determination of cause for any net loss; adequacy of capital; and review of the most recent financial statements. As of December 31, 2020 and 2019, it was determined that the Company's investment in FHLBI stock is appropriately valued at cost, which equates to par value. In addition, other investments include interest bearing deposits with other banks with original maturities of greater than three months. These investments are in denominations, including accrued interest, that are fully insured by the FDIC.

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

Direct financing leases are carried at the aggregate of lease payments plus estimated residual value of the leased property, net of unamortized deferred lease origination fees and costs and unearned income. Interest income on direct financing leases is recognized over the term of the lease to achieve a constant periodic rate of return on the outstanding investment. Effective Janaury 1, 2019, as part of the new leasing standard, only those costs incurred as a direct result of closing a lease transaction are capitalized. All existing deferrals will continue to be amortized over the estimated life of the lease while all new incremental direct costs are expensed immediately.

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

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

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

On March 27, 2020, the President of the United States signed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which provides entities with optional temporary relief from certain accounting and financial reporting requirements under U.S. GAAP. Section 4013 of the CARES Act allows financial institutions to suspend application of certain TDR accounting guidance for loan and lease modifications related to the COVID-19 pandemic made between March 1, 2020 and the earlier of December 31, 2020 or 60 days after the end of the COVID-19 national emergency, provided certain criteria are met. Section 4013 of the CARES Act was amended on December 27, 2020 to extend this relief until January 1, 2022. The relief can be applied to loan and lease modifications for borrowers that were not more than 30 days past due as of December 31, 2019 and to loan and lease modifications that defer or delay the payment of principal or interest, or change the interest rate on the loan. The Company chose to apply this relief to eligible loan and lease modifications. At December 31, 2020, loan and lease modification balances related to the COVID-19 pandemic were $129 million.

The Company sells mortgage loans to the Government National Mortgage Association (GNMA) in the normal course of business and retains the servicing rights. The GNMA programs under which the loans are sold allow the Company to repurchase individual delinquent loans that meet certain criteria from the securitized loan pool. At its option, and without GNMA's prior authorization, the Company may repurchase a delinquent loan for an amount equal to 100% of the remaining principal balance on the loan. Once the Company has the unconditional ability to repurchase a delinquent loan, the Company is deemed to have regained effective control over the loan and the Company is required to recognize the loan on its balance sheet and record an offsetting liability, regardless of its intent to repurchase the loan. At December 31, 2020 and 2019, residential real estate portfolio loans included $2.31 million and $1.44 million, respectively, of loans available for repurchase under the GNMA optional repurchase programs with the offsetting liability recorded within other short-term borrowings.

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

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

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

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

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

Allowance for Credit Losses:

Loans and leases — Accrued interest on loans and leases is excluded from the calculation of the allowance for credit losses due to the Company's charge-off policy to reverse accrued interest on nonperforming loans against interest income in a timely manner. Expected credit losses on net investments in leases, including any unguaranteed residual asset, are included in the allowance for loan and lease losses.

Allowance for Loan and Lease Losses — Effective January 1, 2020, the allowance for credit losses is established for current expected credit losses on the Company's loan and lease portfolio. Prior to January 1, 2020, the allowance was established based on an incurred loss model. It is the Company's policy to maintain the allowance at a level believed to be adequate to absorb estimated credit losses within its portfolio of loans and leases. The determination of the allowance requires significant judgment to estimate credit losses measured on a collective pool basis when similar risk characteristics exist, and for loans evaluated individually. In determining the allowance, the Company estimates expected future losses for the loan's entire contractual term adjusted for expected payments when appropriate. The allowance estimate considers relevant available information, from internal and external sources relating to the historical loss experience, current conditions, and reasonable and supportable forecasts for the Company's outstanding loan and lease balances. The allowance is an estimation that reflects management's evaluation of expected losses related to the Company's financial assets measured at amortized cost. To ensure that the allowance is maintained at an adequate level, a detailed analysis is performed on a quarterly basis and an appropriate provision is made to adjust the allowance.

The Company categorizes its loan portfolios into eight segments based on similar risk characteristics. Loans within each segment are collectively evaluated using either: 1) a cohort cumulative loss rate methodology ("cohort") or, 2) the probability of default ("PD")/loss given default ("LGD") methodology (PD/LGD).

The cohort methodology is applied to ungraded portfolios, portfolios where receipt of financial statements is generally less timely, and portfolios where there are numerous small dollar accounts that are credit scored. Loans are broken out by internal risk rating (loan grade) bands: 1-6 and 7-12 (special attention). For ungraded portfolios, there is only one pool. The cohort methodology has a steady state assumption; qualitative adjustments capture any differences that may exist between the current and historical conditions.

The PD/LGD methodology is applied to graded portfolios due to the quantitative nature of the Company's risk rating system and is consistent with the Company's definition of risk, downgrading a credit where and when appropriate and recognizing losses in a timely manner. Loans are broken out by risk rating (loan grade) bands: 1-3, 4-6, 7-8, and 9-12. The amortized cost loan balances (rather than counts) are used for determining the transition and default probabilities. The Company uses risk rating bands as the active state to track the movement of loans through the transition matrix. The transition frequency is quarterly. Default is defined as the point at which a loan is placed on non-accrual status. In addition, a charge-off is assumed to be a default (i.e. a loan goes from accruing to charge-off, without ever being on non-accrual status). The PD is the cumulative probability of default estimated by use of a transition matrix (based on a Markov transition matrix methodology) which captures the migration of a loan from one risk rating band to another. The LGD is the ratio of loss relative to the exposure (amortized cost) at default.

The current expected credit loss methodology has a factor for reasonable and supportable forecasts. Generally, reasonable and supportable forecasts are for two years or less and have a reversion period of a similar duration, reverting expected credit losses to a level that is consistent with our historical loss experience. Forecast adjustments are added via basis points for the cohort methodology. For the PD/LGD methodology, adjustments to the probability of default factor is applied through forecast adjustments to the PD factor used as the baseline transition matrix runout, thus impacting the historical loss ratio. The Company developed its reasonable and supportable forecasts using relevant data including, but not limited to, growth in gross domestic product, unemployment rates, housing market trends, commodity prices, inflation, and other factors associated with credit losses on the financial statements.

For both the cohort and the PD/LGD methodologies, the Company uses qualitative adjustments to capture differences that may exist between the current and historical conditions. Qualitative factors include but are not limited to current market risk assessment by industry, recent loss experience in particular segments of the portfolios, movement in equipment values collateralizing specialized industry portfolios, concentrations of credit risk, delinquencies, trends in volume, experience and depth of relationship managers and division management, and the effects of changes in lending policies and practices, including changes in quality of the loan and lease origination, servicing and risk management process.

Loans which exhibit different risk characteristics than the pool are evaluated individually for impairment. Loans evaluated individually are not included in the collective evaluation. These loans can be identified from a variety of sources including delinquency, non-accrual status and troubled debt restructurings (TDRs). The scope may include accruing loans that exhibit risk characteristics which differ from their pool or non-performing loans with risk characteristics not similar to other special attention loans in their pool. Individual reserves are determined based on an analysis of the loan's expected future cash flows, the loan's observable market value, or the fair value of the collateral less costs to sell. When foreclosure is probable, impairment is determined based on the collateral's fair value less costs to sell. As a practical expedient, fair value less costs to sell may be used when developing the estimate of credit losses. Similarly, for a going concern analysis, a discounted cash method may be used.

Liability for Credit Losses on Unfunded Loan Commitments — The liability for credit losses on commitments to originate loans and standby letters of credit is included in Accrued Expenses and Other Liabilities on the Consolidated Statements of Financial Condition. Expected credit losses are estimated over the contractual period in which the Company is exposed to credit risk via a contractual obligation unless the obligation is unconditionally cancellable by the Company. The liability for credit losses on unfunded loan commitments is adjusted as a provision for credit losses in Other Noninterest Expense on the Consolidated Statements of Income. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated useful life. Because business processes and credit risks associated with unfunded credit commitments are essentially the same as for loans, the Company utilizes similar processes to estimate its liability for unfunded credit commitments.

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

Lease Commitments — The Company leases certain banking center locations, office space, land and billboards. In determining whether a contract contains a lease, the Company examines the contract to ensure an asset was specifically identified and that the Company has control of use over the asset. To determine whether a lease is classified as operating or finance, the Company performs an economic life test on all building leases with greater than a twenty years term. Further, the Company performs a fair value test to identify any leases that have a present value of future lease payments over the lease term that is greater than 90% of the fair value of the building. The Company only capitalizes leases with an initial lease liability of $2,000 or greater.

At lease inception, the Company determines the lease term by adding together the minimum lease term and all optional renewal periods that it is reasonably certain to renew. The Company determines this on each lease by considering all relevant contract-based, asset-based, market-based, and entity-based economic factors. Generally, the exercise of lease renewal options is at the Company's sole discretion. The lease term is used to determine whether a lease is operating or finance and is used to calculate straight-line rent expense. Additionally, the depreciable life of leasehold improvements is limited by the expected lease term.

Operating lease rentals are expensed on a straight-line basis over the life of the lease beginning on the date the Company takes possession of the property. Rent expense and variable lease costs are included in Net Occupancy Expense on the Consolidated Statements of Income. Included in variable lease costs are leases with rent escalations based on recent financial indices, such as the Consumer Price Index, where the Company estimates future rent increases and records the actual difference to variable costs. Certain leases require the Company to pay common area maintenance, real estate taxes, insurance and other operating expenses associated with the leases premises. These expenses are classified in Net Occupancy Expense on the Consolidated Statements of Income, consistent with similar costs for owned locations. There are no residual value guarantees, restrictions or covenants imposed by leases.

The Company accounts for lease and nonlease components together as a single lease component by class of underlying asset. Operating lease obligations with an initial term longer than 12 months are recorded with a right of use asset and a lease liability on the Consolidated Statements of Financial Condition.

The discount rate used in determining the lease liability and related right of use asset is based upon what would be obtained by the Company for similar loans as an incremental rate as of the date of origination or renewal.

Other Real Estate — Other real estate acquired through partial or total satisfaction of nonperforming loans is included in Other Assets on the Consolidated Statements of Financial Condition and recorded at fair value less anticipated selling costs based upon the property's appraised value at the date of transfer, with any difference between the fair value of the property less cost to sell, and the carrying value of the loan charged to the allowance for loan and lease losses or other income, if a positive adjustment. Subsequent fair value write-downs or write-ups, to the extent of previous write-downs, property maintenance costs, and gains or losses recognized upon the sale of other real estate are recognized in Noninterest Expense on the Consolidated Statements of Income. Gains or losses resulting from the sale of other real estate are recognized on the date of sale. As of December 31, 2020 and 2019, other real estate had carrying values of $0.36 million and $0.52 million, respectively, and is included in Other Assets on the Consolidated Statements of Financial Condition.

Repossessed Assets — Repossessed assets may include fixtures and equipment, inventory and receivables, aircraft, construction equipment, and vehicles acquired from business banking and specialty finance activities. Repossessed assets are included in Other Assets on the Consolidated Statements of Financial Condition at fair value of the equipment or vehicle less estimated selling costs. At the time of repossession, the recorded amount of the loan or lease is written down to the fair value of the equipment or vehicle by a charge to the allowance for loan and lease losses or other income, if a positive adjustment. Subsequent fair value write-downs or write-ups, to the extent of previous write-downs, equipment maintenance costs, and gains or losses recognized upon the sale of repossessions are recognized in Noninterest Expense on the Consolidated Statements of Income. Gains or losses resulting from the sale of repossessed assets are recognized on the date of sale. Repossessed assets totaled $1.98 million and $8.62 million, as of December 31, 2020 and 2019, respectively, and are included in Other Assets on the Consolidated Statements of Financial Condition.

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

Goodwill and Intangibles — Goodwill represents the excess of the cost of businesses acquired over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Goodwill is reviewed for impairment at least annually or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the carrying amount. Goodwill is allocated into two reporting units. Fair value for each reporting unit is estimated using stock price multiples or earnings before interest, tax, depreciation and amortization (EBITDA) multiples. Intangible assets that have finite lives are amortized over their estimated useful lives and are subject to impairment testing. All of the Company's other intangible assets have finite lives and are amortized on a straight-line basis over varying periods not exceeding twenty-five years.

The Company has historically evaluated goodwill for impairment during the fourth quarter of each year, with financial data as of September 30. During the first quarter of 2020, management determined that the deterioration in general economic conditions as a result of the COVID-19 pandemic and responses thereto represented a triggering event prompting an evaluation of goodwill impairment. Based on the analyses performed each quarter of 2020, the Company determined that goodwill was not impaired.

Partnership Investments — The partnerships in which the Company has investments account for their investments at fair value. As a result, the Company's investments in these partnerships reflect the underlying fair value of the partnerships' investments. The Company accounts for its investments in partnerships for which it owns three percent or more of the partnership on the equity method. The Company accounts for its investments in partnerships of which it owns less than three percent at fair value less impairment. The Company has elected to use the practical expedient to estimate fair value of an investment in an investment company using the net asset value of its partnership interest. The Company uses the hypothetical liquidation book value (HLBV) method for equity investments when the liquidation rights and priorities as defined by an equity investment agreement differ from what is reflected by the underlying percentage ownership interests. The HLBV method is commonly applied to equity investments in the renewable energy industry, where cash percentages vary at different points in time and are not directly linked to an investor's ownership percentage. A calculation is prepared at each balance sheet date to determine the amount that the Company would receive if an equity investment entity were to liquidate all of its assets (as valued in accordance with GAAP) and distribute that cash to the investors based on the contractually defined liquidation priorities. The difference between the calculated liquidation distribution amounts at the beginning and the end of the reporting period, after adjusting for capital contributions and distributions, is 1st Source's share of the earnings or losses from the equity investment for the period. Investments in partnerships are included in Other Assets on the Consolidated Statements of Financial Condition. The balances as of December 31, 2020 and 2019 were $76.35 million and $61.08 million, respectively.

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

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

Revenue Recognition — The Company recognizes revenues as they are earned based on contractual terms, as transactions occur, or as services are provided and collectability is reasonably assured. The Company's principal source of revenue is interest income from loans and leases and investment securities. The Company also earns noninterest income from various banking and financial services offered primarily through 1st Source Bank and its subsidiaries.

Interest Income — The largest source of revenue for the Company is interest income which is primarily recognized on an accrual basis according to nondiscretionary formulas in written contracts, such as loan and lease agreements or investment securities contracts.

Noninterest Income — The Company earns noninterest income through a variety of financial and transaction services provided to corporate and consumer clients such as trust and wealth advisory, deposit account, debit card, mortgage banking, insurance, and equipment rental services. Revenue is recorded for noninterest income based on the contractual terms for the service or transaction performed. In certain circumstances, noninterest income is reported net of associated expenses.

Trust and Wealth Advisory Fees — Trust and wealth advisory fees are recognized on the accrual basis.

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

The Company uses the deferral method of accounting on investments that generate investment tax credits. Under this method, the investment tax credits are recognized as a reduction to the related asset. The expense on certain qualified affordable housing investments is included in Tax Expense on the Consolidated Statements of Income.

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

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

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

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

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

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

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

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

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

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

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

Note 2 — Recent Accounting Pronouncements

<u>Nonrefundable Fees and Other Costs:</u> In October 2020, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2020-08 *"Codification Improvements to Subtopic 310-20, Receivables–Nonrefundable Fees and Other Costs."* This ASU clarifies that an entity should reevaluate whether a callable debt security is within the scope of ASC paragraph 310-20-35-33 for each reporting period. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early application is not permitted. All entities should apply ASU 2020-08 on a prospective basis as of the beginning of the period of adoption for existing or newly purchased callable debt securities. The Company adopted ASU 2020-08 as of January 1, 2021 and it did not have a material impact on its accounting and disclosures.

Reference Rate Reform: In March 2020, the FASB issued ASU No. 2020-04 *"Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting."* These amendments provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. In January 2021, the FASB issued ASU 2021-01 which clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. The Company is implementing a transition plan to identify and modify its loans and other financial instruments with attributes that are either directly or indirectly influenced by LIBOR. The Company is continuing to assess ASU 2020-04 and its impact on the Company's transition away from LIBOR for its loan and other financial instruments.

Partnership Investments and Derivatives: In January 2020, the FASB issued ASU No. 2020-01 *"Investments-Equity Securities (Topic 321), Investments-Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) - Clarifying the Interactions between Topic 321, Topic 323, and Topic 815."* These amendments, among other things, clarify that a company should consider observable transactions that require a company to either apply or discontinue the equity method of accounting under Topic 323, Investments-Equity Method and Joint Ventures, for the purposes of applying the measurement alternative in accordance with Topic 321 immediately before applying or upon discontinuing the equity method. The amendments also clarify that, when determining the accounting for certain forward contracts and purchased options a company should not consider, whether upon settlement or exercise, if the underlying securities would be accounted for under the equity method or fair value option. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early application is permitted, including early adoption in an interim period. An entity should apply ASU 2020-01 prospectively at the beginning of the interim period that includes the adoption date. The Company adopted ASU 2020-01 on January 1, 2021 and it did not have a material impact on its accounting and disclosures.

Income Taxes: In December 2019, the FASB issued ASU 2019-12 *"Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes."* These amendments remove specific exceptions to the general principles in Topic 740 in GAAP. It eliminates the need for an organization to analyze whether the following apply in a given period: exception to the incremental approach for intraperiod tax allocation; exceptions to accounting for basis differences where there are ownership changes in foreign investments; and exception in interim period income tax accounting for year-to-date losses that exceed anticipated losses. It also improves financial statement preparers' application of income tax-related guidance and simplifies GAAP for: franchise taxes that are partially based on income; transactions with a government that result in a step up in the tax basis of goodwill; separate financial statements of legal entities that are not subject to tax; and enacts changes in tax laws in interim periods. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption is permitted. The Company adopted ASU 2019-12 on January 1, 2021 and it did not have a material impact on its accounting and disclosures.

Measurement of Credit Losses on Financial Instruments: In June 2016, the FASB issued ASU No. 2016-13, *"Financial Instruments-Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments (CECL)."* The provisions of ASU 2016-13 were issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. ASU 2016-13 requires that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in ASU 2016-13 eliminate the probable incurred loss recognition in current GAAP and reflect an entity's current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the financial assets.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security.

The FASB issued additional ASUs containing clarifying guidance, transition relief provisions and minor updates to the original ASU. These include ASU 2018-19 (issued November 2018), ASU 2019-04 (issued April 2019), ASU 2019-05 (issued May 2019), ASU 2019-10 (issued November 2019), ASU 2019-11 (issued November 2019), ASU 2020-02 (issued February 2020) and ASU 2020-03 (issued March 2020). ASU 2016-13 and subsequent ASUs are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. This amendment is required to be adopted using a modified retrospective approach with a cumulative-effect adjustment to beginning retained earnings, as of the beginning of the first reporting period in which the guidance is effective.

As previously disclosed, the Company formed a cross-functional team to work through its implementation plan. The Company's cross-functional team completed the assessment and documentation of processes, internal controls, data and model validation testing, parallel testing, qualitative factors and forecast periods as well as model development. The Company implemented a third-party software solution to assist in the application of the new standard including portfolio segmentation according to shared risk characteristics and modeling methodologies. The Company had finalized the formal review and approval process and the results of its CECL estimate as of year-end 2019 but elected to delay its adoption of ASU 2016-13, as approved by the Coronavirus Aid, Relief, and Economic Security (CARES) Act, until December 31, 2020. Upon adoption of ASU 2016-13, the Company recognized a one-time cumulative effect adjustment decreasing retained earnings as of January 1, 2020 by $2.55 million, net of deferred taxes of $0.81 million.

Upon adopting ASU 2016-13, the Company did not record an allowance as of January 1, 2020 with respect to its available-for-sale debt securities as the majority of these securities are government agency-backed securities for which the risk of loss is minimal. The adoption of ASU 2016-13 did not have a significant impact on the Company's regulatory capital ratios.

The accounting policies stated in Note 1 relating to the allowance for credit losses on available-for-sale investment securities, loans and leases and unfunded loan commitments reflect the current accounting policies required by ASU 2016-13. Disclosures relating to prior year accounting policies can be found in the 2019 Annual Report on Form 10-K.

The main drivers of the adjustment to retained earnings are summarized in the following table.

(Dollar in thousands)	Pre-ASC 326 Adoption December 31, 2019	Impact of ASC 326 Adoption	As Reported Under ASC 326 January 1, 2020
Allowance for credit losses			
Commercial and agricultural	$ 23,671	$ (655)	$ 23,016
Auto and light truck	14,400	(1,303)	13,097
Medium and heavy duty truck	4,612	2,414	7,026
Aircraft	31,058	484	31,542
Construction equipment	14,120	372	14,492
Commercial real estate	18,350	(649)	17,701
Residential real estate and home equity	3,609	1,688	5,297
Consumer	1,434	233	1,667
Total allowance for credit losses on loans and leases	111,254	2,584	113,838
Accrued expenses and other liabilities (unfunded loan commitments)	3,172	777	3,949
Total allowance for credit losses	$ 114,426	$ 3,361	$ 117,787

Note 3 — Investment Securities Available-For-Sale

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

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2020				
U.S. Treasury and Federal agencies securities	**$ 610,195**	**$ 9,521**	**$ (234)**	**$ 619,482**
U.S. States and political subdivisions securities	**78,812**	**2,346**	**(31)**	**81,127**
Mortgage-backed securities - Federal agencies	**442,748**	**11,237**	**(196)**	**453,789**
Corporate debt securities	**40,813**	**1,556**	**—**	**42,369**
Foreign government securities	**700**	**—**	**—**	**700**
Total investment securities available-for-sale	**$ 1,173,268**	**$ 24,660**	**$ (461)**	**$ 1,197,467**
December 31, 2019				
U.S. Treasury and Federal agencies securities	$ 524,896	$ 2,538	$ (470)	$ 526,964
U.S. States and political subdivisions securities	83,566	1,048	(109)	84,505
Mortgage-backed securities - Federal agencies	372,458	3,948	(1,017)	375,389
Corporate debt securities	52,151	890	(16)	53,025
Foreign government securities	700	—	—	700
Total investment securities available-for-sale	$ 1,033,771	$ 8,424	$ (1,612)	$ 1,040,583

Amortized cost excludes accrued interest receivable which is included in Accrued Income and Other Assets on the Consolidated Statements of Financial Condition. At December 31, 2020 and 2019, accrued interest receivable on investment securities available for sale was $3.84 million and $4.24 million, respectively.

At December 31, 2020, the residential mortgage-backed securities held by the Company consisted primarily of GNMA, FNMA and FHLMC pass-through certificates which are guaranteed by those respective agencies of the United States government (Government Sponsored Enterprise, GSEs).

The Company did not hold any marketable equity securities at December 31, 2020 and 2019.

The following table shows the contractual maturities of investments in debt securities available-for-sale at December 31, 2020. 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	$ 115,555	$ 116,556
Due after one year through five years	525,017	537,183
Due after five years through ten years	89,368	89,359
Due after ten years	580	580
Mortgage-backed securities	442,748	453,789
Total debt securities available-for-sale	**$ 1,173,268**	**$ 1,197,467**

The following table summarizes gross unrealized losses and fair value by investment category and age. At December 31, 2020, the Company's available-for-sale securities portfolio consisted of 623 securities, 54 of which were in an unrealized loss position.

	Less than 12 Months		12 months or Longer		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2020						
U.S. Treasury and Federal agencies securities	**$ 136,534**	**$ (234)**	**$ —**	**$ —**	**$ 136,534**	**$ (234)**
U.S. States and political subdivisions securities	**6,391**	**(30)**	**199**	**(1)**	**6,590**	**(31)**
Mortgage-backed securities - Federal agencies	**67,736**	**(187)**	**3,274**	**(9)**	**71,010**	**(196)**
Corporate debt securities	**—**	**—**	**—**	**—**	**—**	**—**
Foreign government securities	**200**	**—**	**—**	**—**	**200**	**—**
Total debt securities available-for-sale	**$ 210,861**	**$ (451)**	**$ 3,473**	**$ (10)**	**$ 214,334**	**$ (461)**
December 31, 2019						
U.S. Treasury and Federal agencies securities	$ 87,352	$ (171)	$ 69,053	$ (299)	$ 156,405	$ (470)
U.S. States and political subdivisions securities	9,283	(107)	1,042	(2)	10,325	(109)
Mortgage-backed securities - Federal agencies	81,951	(383)	51,165	(634)	133,116	(1,017)
Corporate debt securities	—	—	8,091	(16)	8,091	(16)
Foreign government securities	—	—	—	—	—	—
Total debt securities available-for-sale	$ 178,586	$ (661)	$ 129,351	$ (951)	$ 307,937	$ (1,612)

The Company does not consider available-for-sale securities with unrealized losses at December 31, 2020 to be experiencing credit losses and recognized no resulting allowance for credit losses. The Company does not intend to sell these investments and it is more likely than not that the Company will not be required to sell these investments before recovery of the amortized cost basis, which may be the maturity dates of the securities. The unrealized losses occurred as a result of changes in interest rates, market spreads and market conditions subsequent to purchase.

The following table shows the gross realized gains and losses from the securities available-for-sale portfolio, including marketable equity securities.

(Dollars in thousands)	**2020**	2019	2018
Gross realized gains	**$ 285**	$ —	$ 2
Gross realized losses	**(6)**	—	(347)
Net realized gains (losses)	**$ 279**	$ —	$ (345)

At December 31, 2020 and 2019, investment securities with carrying values of $338.68 million and $281.38 million, respectively, were pledged as collateral for security repurchase agreements and for other purposes.

Note 4 — Loan and Lease Financings

Total loans and leases outstanding were recorded net of unearned income and deferred loan fees and costs at December 31, 2020 and 2019, and totaled $5.49 billion and $5.09 billion, respectively. At December 31, 2020 and 2019, net deferred loan and lease (fees) costs were $(3.73) million and $5.06 million, respectively. At December 31, 2020, there were $6.37 million in deferred loan fees related to Paycheck Protection Program (PPP) loans. Accrued interest receivable on loans and leases at December 31, 2020 and 2019 was $16.39 million and $14.81 million, respectively.

In the ordinary course of business, the Company has extended loans to certain directors, executive officers, and principal shareholders of equity securities of 1st Source and to their affiliates. In the opinion of management, these loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not related to the Company and did not involve more than the normal risk of collectability, or present other unfavorable features. The loans are consistent with sound banking practices and within applicable regulatory and lending limitations. The aggregate dollar amounts of these loans were $26.51 million and $17.08 million at December 31, 2020 and 2019, respectively. During 2020, $11.91 million of new loans and other additions were made and $2.48 million of repayments and other reductions occurred.

The Company evaluates loans and leases for credit quality at least annually but more frequently if certain circumstances occur (such as material new information which becomes available and indicates a potential change in credit risk). The Company uses two methods to assess credit risk: loan or lease credit quality grades and credit risk classifications. The purpose of the loan or lease credit quality grade is to document the degree of risk associated with individual credits as well as inform management of the degree of risk in the portfolio taken as a whole. Credit risk classifications are used to categorize loans by degree of risk and to designate individual or committee approval authorities for higher risk credits at the time of origination. Credit risk classifications include categories for: Acceptable, Marginal, Special Attention, Special Risk, Restricted by Policy, Regulated and Prohibited by Law.

All loans and leases, except residential real estate and home equity loans and consumer loans, are assigned credit quality grades on a scale from 1 to 12 with grade 1 representing superior credit quality. The criteria used to assign grades to extensions of credit that exhibit potential problems or well-defined weaknesses are primarily based upon the degree of risk and the likelihood of orderly repayment, and their effect on our safety and soundness. Loans or leases graded 7 or weaker are considered "special attention" credits and, as such, relationships in excess of $100,000 are reviewed quarterly as part of management's evaluation of the appropriateness of the allowance for loan and lease losses. Grade 7 credits are defined as "watch" and contain greater than average credit risk and are monitored to limit our exposure to increased risk; grade 8 credits are "special mention" and, following regulatory guidelines, are defined as having potential weaknesses that deserve management's close attention. Credits that exhibit well-defined weaknesses and a distinct possibility of loss are considered ''classified'' and are graded 9 through 12 corresponding to the regulatory definitions of "substandard" (grades 9 and 10) and the more severe ''doubtful'' (grade 11) and ''loss'' (grade 12). For residential real estate and home equity and consumer loans, credit quality is based on the aging status of the loan and by payment activity. Nonperforming loans are those loans which are on nonaccrual status or are 90 or more past due.

Below is a summary of the Company's loan and lease portfolio segments and a discussion of the risk characteristics relevant to each portfolio segment.

Commercial and agricultural – loans are to entities within the Company's local market communities. Loans are for business or agri-business purposes and include working capital lines of credit secured by accounts receivable and inventory that are generally renewable annually and term loans secured by equipment with amortizations based on the expected life of the underlying collateral, generally three to seven years. These loans are typically further supported by personal guarantees. Commercial exposure is to a wide range of industries and services. Risks in this sector are also varied and are most impacted by general economic conditions. Risk mitigants include appropriate underwriting and monitoring and, when appropriate, government guarantees, including SBA and FSA. This portfolio sector also includes solar loans which are not local market credits, and PPP loans, which are fully guaranteed by the SBA. Total PPP loan originations during 2020 amounted to $597.45 million. As of December 31, 2020, PPP loan balances were $351.56 million which is net of an unearned discount of $6.37 million.

Auto and light truck – loans are secured by vehicles and borrowers are nationwide. The portfolio consists of multiple industries: auto rental, auto leasing and specialty vehicle which includes bus, funeral car and step van. Borrowers in the auto rental segment are primarily independent auto rental entities with on-airport and off-airport locations, and some insurance replacement business. Loan amortizations are relatively short, generally eighteen months, but up to four years. Auto leasing customers lease to businesses and the Company takes assignment of the lease stream and places its lien on the vehicles. Terms are generally longer than the auto rental sector, three to seven years and match the underlying leases. Risks in both these segments include economic risks and collateral risks, principally used vehicle values. The bus segment is secured primarily by shuttle busses and motor coaches. Risks include lack of well-established mechanisms for disposition of collateral, such as auctions that are key to disposition of autos. Loans in the portfolio generally carry personal guarantees.

Medium and heavy duty truck – loans and full-service truck leases are secured by heavy-duty trucks, commonly Class 8 trucks, and are generally personally guaranteed. In addition to economic risks, collateral risk is significant. Financing is generally at full cost, plus additional expenditures to get the vehicle operational, such as taxes, insurance and fees. It takes three to four years of debt amortization to reach an equity position in the collateral.

Aircraft – loans are to domestic and foreign borrowers with the domestic segment further divided into two pools: 1) personal and business use, and 2) dealers and operators. The Company's focus for the foreign sector is Latin America, principally Mexico and Brazil. Loans are primarily secured by new and used business jets and helicopters, with appropriate advances, amortizations of ten to fifteen years, and are generally guaranteed by individuals. The most significant risk in the Aircraft portfolio is collateral risk - volatility in underlying values and maintenance concerns. The portfolio is subject to national and global economic risks.

Construction equipment – loans are to borrowers throughout the country secured by specific equipment. The borrowers include highway and road builders, asphalt producers and pavers, suppliers of aggregate products, site developers, frac sand operations, general construction equipment dealers and operators, and crane rental entities. Generally, loans include personal guarantees. The construction equipment industry is heavily dependent on the U.S. economy and the global economy. Market growth is reliant on investments from public and private sectors into urbanization and infrastructure projects.

Commercial real estate – loans are generally to entities within the local market communities served by the Company with advances generally within regulatory guidelines. Historically, the Company's exposure to commercial real estate had been primarily to the less risky owner-occupied segment although growth in recent years has been in the non-owner-occupied segment which now accounts for slightly less than half of the portfolio. The non-owner-occupied segment includes hotels, apartment complexes and warehousing facilities. There is limited exposure to construction loans. Many commercial real estate loans carry personal guarantees. Additional risks in the commercial real estate portfolio stem from geographical concentration in northern Indiana and southwest Michigan and general economic conditions.

Residential real estate and home equity – loans predominantly include one-to-four family mortgages to borrowers in the Company's local market communities and are appropriately underwritten and secured by residential real estate.

Consumer – loans are to individuals in the Company's local markets and auto loans are generally secured by personal vehicles and appropriately underwritten.

The following table shows the amortized cost of loans and leases, segregated by portfolio segment, credit quality rating and year of origination as of December 31, 2020.

	Term Loans and Leases by Origination Year								
(Dollars in thousands)	**2020**	**2019**	**2018**	**2017**	**2016**	**Prior**	**Revolving Loans**	**Revolving Loans Converted to Term**	**Total**
Commercial and agricultural									
Grades 1-6	$ 666,905	$ 193,555	$ 134,411	$ 92,916	$ 26,034	$ 19,790	$ 291,990	$ —	$ 1,425,601
Grades 7-12	6,788	1,699	4,726	3,507	1,200	2,134	33,067	—	53,121
Total commercial and agricultural	**673,693**	**195,254**	**139,137**	**96,423**	**27,234**	**21,924**	**325,057**	**—**	**1,478,722**
Auto and light truck									
Grades 1-6	248,932	141,841	52,749	24,101	4,210	608	—	—	472,441
Grades 7-12	19,113	27,136	12,796	8,612	2,250	21	—	—	69,928
Total auto and light truck	**268,045**	**168,977**	**65,545**	**32,713**	**6,460**	**629**	**—**	**—**	**542,369**
Medium and heavy duty truck									
Grades 1-6	92,698	88,314	44,205	31,773	15,644	4,840	—	—	277,474
Grades 7-12	—	978	—	—	632	88	—	—	1,698
Total medium and heavy duty truck	**92,698**	**89,292**	**44,205**	**31,773**	**16,276**	**4,928**	**—**	**—**	**279,172**
Aircraft									
Grades 1-6	429,283	153,358	93,042	95,457	43,972	20,966	6,370	—	842,448
Grades 7-12	11,519	2,561	479	596	2,187	1,670	—	—	19,012
Total aircraft	**440,802**	**155,919**	**93,521**	**96,053**	**46,159**	**22,636**	**6,370**	**—**	**861,460**
Construction equipment									
Grades 1-6	311,174	180,550	96,320	42,713	12,624	5,722	17,502	737	667,342
Grades 7-12	17,518	13,743	10,642	398	237	85	2,988	1,935	47,546
Total construction equipment	**328,692**	**194,293**	**106,962**	**43,111**	**12,861**	**5,807**	**20,490**	**2,672**	**714,888**
Commercial real estate									
Grades 1-6	190,725	204,477	173,847	175,009	69,022	122,762	373	—	936,215
Grades 7-12	9,518	7,990	5,173	6,684	1,762	2,522	—	—	33,649
Total commercial real estate	**200,243**	**212,467**	**179,020**	**181,693**	**70,784**	**125,284**	**373**	**—**	**969,864**
Residential real estate and home equity									
Performing	133,829	65,690	18,194	22,929	41,847	86,106	135,255	5,703	509,553
Nonperforming	—	—	21	14	—	1,435	247	109	1,826
Total residential real estate and home equity	**133,829**	**65,690**	**18,215**	**22,943**	**41,847**	**87,541**	**135,502**	**5,812**	**511,379**
Consumer									
Performing	43,824	34,409	18,904	7,005	2,259	793	23,869	—	131,063
Nonperforming	2	99	78	36	8	2	159	—	384
Total consumer	**$ 43,826**	**$ 34,508**	**$ 18,982**	**$ 7,041**	**$ 2,267**	**$ 795**	**$ 24,028**	**$ —**	**$ 131,447**

The following table shows the amortized cost of loans and leases, segregated by portfolio segment, with delinquency aging and nonaccrual status.

(Dollars in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Accruing	Total Accruing Loans	Nonaccrual	Total Financing Receivables
December 31, 2020							
Commercial and agricultural	**$ 1,472,755**	**$ 34**	**$ —**	**$ —**	**$ 1,472,789**	**$ 5,933**	**$ 1,478,722**
Auto and light truck	**504,659**	**560**	**205**	**—**	**505,424**	**36,945**	**542,369**
Medium and heavy duty truck	**278,452**	**—**	**—**	**—**	**278,452**	**720**	**279,172**
Aircraft	**860,632**	**—**	**—**	**—**	**860,632**	**828**	**861,460**
Construction equipment	**701,124**	**1,093**	**298**	**—**	**702,515**	**12,373**	**714,888**
Commercial real estate	**968,370**	**—**	**—**	**—**	**968,370**	**1,494**	**969,864**
Residential real estate and home equity	**508,532**	**782**	**239**	**108**	**509,661**	**1,718**	**511,379**
Consumer	**130,458**	**504**	**101**	**7**	**131,070**	**377**	**131,447**
Total	**$ 5,424,982**	**$ 2,973**	**$ 843**	**$ 115**	**$ 5,428,913**	**$ 60,388**	**$ 5,489,301**
December 31, 2019							
Commercial and agricultural	$ 1,131,704	$ 118	$ —	$ —	$ 1,131,822	$ 969	$ 1,132,791
Auto and light truck	586,212	1,268	77	—	587,557	1,250	588,807
Medium and heavy duty truck	293,736	14	—	—	293,750	1,074	294,824
Aircraft	772,846	7,026	3,293	—	783,165	875	784,040
Construction equipment	702,671	819	609	—	704,099	1,352	705,451
Commercial real estate	906,468	58	—	—	906,526	1,651	908,177
Residential real estate and home equity	528,844	561	152	257	529,814	2,189	532,003
Consumer	138,132	632	187	54	139,005	429	139,434
Total	$ 5,060,613	$ 10,496	$ 4,318	$ 311	$ 5,075,738	$ 9,789	$ 5,085,527

Interest income for the years ended December 31, 2020, 2019, and 2018, would have increased by approximately $3.49 million, $0.69 million, and $2.18 million, respectively, if the nonaccrual loans and leases had earned interest at their full contract rate.

The following table shows impaired loans and leases, segregated by portfolio segment, and the corresponding allowance for impaired loans and leases.

(Dollars in thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
December 31, 2019			
With no related allowance recorded:			
Commercial and agricultural	$ 218	$ 218	$ —
Auto and light truck	853	853	—
Medium and heavy duty truck	1,074	1,074	—
Aircraft	875	875	—
Construction equipment	615	615	—
Commercial real estate	1,487	1,487	—
Residential real estate and home equity	—	—	—
Consumer	—	—	—
Total with no related allowance recorded	5,122	5,122	—
With an allowance recorded:			
Commercial and agricultural	10,366	10,366	3,003
Auto and light truck	278	278	30
Medium and heavy duty truck	—	—	—
Aircraft	—	—	—
Construction equipment	736	736	75
Commercial real estate	—	—	—
Residential real estate and home equity	337	339	117
Consumer	—	—	—
Total with an allowance recorded	11,717	11,719	3,225
Total impaired loans	$ 16,839	$ 16,841	$ 3,225

The following table shows average recorded investment and interest income recognized on impaired loans and leases, segregated by portfolio segment, for the years ending December 31, 2019 and 2018.

	2019		2018	
(Dollars in thousands)	Average Recorded Investment	Interest Income	Average Recorded Investment	Interest Income
Commercial and agricultural	$ 5,983	$ 242	$ 2,812	$ —
Auto and light truck	2,721	—	9,352	—
Medium and heavy duty truck	244	—	247	—
Aircraft	2,409	8	9,987	20
Construction equipment	1,664	—	1,663	—
Commercial real estate	1,715	—	2,303	—
Residential real estate and home equity	340	19	347	15
Consumer loans	—	—	—	—
Total	$ 15,076	$ 269	$ 26,711	$ 35

The following table shows the number of loans and leases classified as troubled debt restructuring (TDR) during 2020, 2019 and 2018, by portfolio segment, as well as the recorded investment as of December 31. The classification between nonperforming and performing is shown at the time of modification. Modification programs focused on extending maturity dates or modifying payment patterns with most TDRs experiencing a combination of concessions. The modifications did not result in the contractual forgiveness of principal or interest. The TDRs during 2020 were the result of issues that predated the COVID-19 pandemic. There were two modifications during 2020, one modification during 2019, and no modifications during 2018 that resulted in an interest rate reduction below market rate. Consequently, the financial impact of the modifications was immaterial.

	2020		2019		2018	
(Dollars in thousands)	**Number of Modifications**	**Recorded Investment**	Number of Modifications	Recorded Investment	Number of Modifications	Recorded Investment
Performing TDRs:						
Commercial and agricultural	—	**$ —**	1	$ 9,901	—	$ —
Auto and light truck	—	—	—	—	—	—
Medium and heavy duty truck	—	—	—	—	—	—
Aircraft	—	—	—	—	—	—
Construction equipment	—	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—
Residential real estate and home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total performing TDR modifications	—	—	1	9,901	—	—
Nonperforming TDRs:						
Commercial and agricultural	—	—	1	465	—	—
Auto and light truck	—	—	—	—	1	285
Medium and heavy duty truck	—	—	—	—	—	—
Aircraft	**1**	**828**	—	—	—	—
Construction equipment	**1**	**9,905**	—	—	—	—
Commercial real estate	—	—	—	—	—	—
Residential real estate and home equity	—	—	—	—	—	—
Consumer	—	—	—	—	—	—
Total nonperforming TDR modifications	**2**	**10,733**	1	465	1	285
Total TDR modifications	**2**	**$ 10,733**	2	$ 10,366	1	$ 285

There was one nonperforming commercial and agricultural TDR with a recorded investment of $0.41 million which had a payment default within the twelve months following modification for the year ended December 31, 2020, one nonperforming auto and light truck TDR with a recorded investment of $0.00 million which had a payment default within the twelve months following modification for the year ended December 31, 2019, and no TDRs which had a payment default within the twelve months following modification during the year ended December 31, 2018.

The classification between nonperforming and performing is shown at the time of modification. Default occurs when a loan or lease is 90 days or more past due under the modified terms or transferred to nonaccrual.

The following table shows the recorded investment of loans and leases classified as troubled debt restructurings as of December 31.

Year Ended December 31 *(Dollars in thousands)*	**2020**	2019
Performing TDRs	**$ 330**	$ 10,238
Nonperforming TDRs	**11,156**	486
Total TDRs	**$ 11,486**	$ 10,724

Note 5 — Allowance for Credit Losses

Allowance for Loan and Lease Losses

The methodology used to estimate the appropriate level of the allowance for loan and lease losses is described in Note 1, under the heading "Allowance for Credit Losses." The allowance for loan and lease losses at December 31, 2020, represents the Company's current estimate of lifetime credit losses inherent in the loan and lease portfolio. The following table shows the changes in the allowance for loan and lease losses, segregated by portfolio segment, for each of the three years ended December 31.

(Dollars in thousands)	Commercial and agricultural	Auto and light truck	Medium and heavy duty truck	Aircraft	Construction equipment	Commercial real estate	Residential real estate and home equity	Consumer	Total
2020									
Balance, beginning of year	**$ 23,671**	**$ 14,400**	**$ 4,612**	**$ 31,058**	**$ 14,120**	**$ 18,350**	**$ 3,609**	**$ 1,434**	**$ 111,254**
Impact of ASC 326 adoption	**(655)**	**(1,303)**	**2,414**	**484**	**372**	**(649)**	**1,688**	**233**	**2,584**
Adjusted balance, beginning of year	**23,016**	**13,097**	**7,026**	**31,542**	**14,492**	**17,701**	**5,297**	**1,667**	**113,838**
Charge-offs	**903**	**7,107**	**15**	**855**	**4,090**	**37**	**74**	**893**	**13,974**
Recoveries	**663**	**499**	**18**	**1,800**	**1,415**	**58**	**33**	**303**	**4,789**
Net charge-offs	**240**	**6,608**	**(3)**	**(945)**	**2,675**	**(21)**	**41**	**590**	**9,185**
Provision (recovery of provision)	**(547)**	**22,437**	**(629)**	**1,566**	**7,349**	**5,036**	**118**	**671**	**36,001**
Balance, end of year	**$ 22,229**	**$ 28,926**	**$ 6,400**	**$ 34,053**	**$ 19,166**	**$ 22,758**	**$ 5,374**	**$ 1,748**	**$ 140,654**
2019									
Balance, beginning of year	$ 17,063	$ 14,689	$ 4,303	$ 33,047	$ 10,922	$ 15,705	$ 3,425	$ 1,315	$ 100,469
Charge-offs	1,040	991	1,132	3,066	238	5	53	1,066	7,591
Recoveries	664	97	32	1,143	160	75	85	287	2,543
Net charge-offs (recoveries)	376	894	1,100	1,923	78	(70)	(32)	779	5,048
Provision (recovery of provision)	6,984	605	1,409	(66)	3,276	2,575	152	898	15,833
Balance, end of year	$ 23,671	$ 14,400	$ 4,612	$ 31,058	$ 14,120	$ 18,350	$ 3,609	$ 1,434	$ 111,254
2018									
Balance, beginning of year	$ 16,228	$ 10,103	$ 4,844	$ 34,619	$ 9,343	$ 14,792	$ 3,666	$ 1,288	$ 94,883
Charge-offs	229	3,308	23	12,222	288	70	63	909	17,112
Recoveries	222	68	—	2,499	100	53	23	271	3,236
Net charge-offs (recoveries)	7	3,240	23	9,723	188	17	40	638	13,876
Provision (recovery of provision)	842	7,826	(518)	8,151	1,767	930	(201)	665	19,462
Balance, end of year	$ 17,063	$ 14,689	$ 4,303	$ 33,047	$ 10,922	$ 15,705	$ 3,425	$ 1,315	$ 100,469

The allowance for loan and lease losses increased year-over-year in 2020 for most portfolio segments due to downward migration in credit quality and increased risk as a result of the pandemic. The impact of adopting ASC 326 is also noted for each loan segment. Generally, a decrease in the allowance upon adoption was related to shorter duration assets in the loan class and likewise, an increase was generally due to longer duration assets.

Commercial and agricultural – loan growth was due primarily to PPP loans which have minimal credit risk. The decline in the allowance was principally due to the impact of the short duration lines of credit driving lower reserves and minimal reserves for PPP loans.

Auto and light truck – allowance increased as a result of the significant impact the pandemic had on the portfolio, which includes the particularly hard-hit bus industry. The increase related to credit deterioration was somewhat offset by a lower allowance for the auto rental industry due to the short average duration of the loans. Loan balances declined somewhat year-over-year.

Medium and heavy duty truck – allowance decrease was principally attributable to credit quality metrics continuing to be relatively strong therefore a recovery of provision was recognized during the period.

Aircraft – the allowance was principally impacted by loan growth. The Company has historically carried a higher allowance in this portfolio due to volatility. The higher allowance during the period was due to charge-offs impacting the loss history and the long duration assets.

Construction equipment – allowance increase was mainly driven by exposure to mining and frac sand industries. While the total Company exposure is limited, the impact of lower oil prices on this portfolio was relevant.

Commercial real estate – allowance increase was a result of loan growth and exposure to industries hardest hit by the pandemic, i.e. hotels and accommodations and, to a lesser extent, retail and office buildings. The Company's exposure to these industries is limited, but the impact was noticeable in this asset class.

Residential real estate and home equity – increased allowance as a result of longer asset duration.

Consumer – segment saw an increase in allowance due to portfolio mix and duration.

Economic Outlook

As of December 31, 2020, the COVID-19 pandemic created extraordinary circumstances affecting the loan and lease portfolios. The forecast considers global and domestic economic effects from the ongoing pandemic as well as the potential impact of U.S. monetary and fiscal policy, including the recently passed Coronavirus Response and Relief Supplemental Appropriations Act, which may impact clients; particularly those who will benefit from a second round of paycheck protection program funds or targeted funds for struggling industry sectors such as transportation. The Company's assumption was that the economic slowdown will have an adverse impact on the loan and lease portfolio over the next two years. GDP is expected to grow throughout 2021 but is not expected to return to pre-pandemic levels until 2022. Likewise, unemployment is not likely to get back to pre-shutdown levels until 2022.

As a result of the unprecedented economic uncertainty caused by the COVID-19 pandemic, the Company's future loss estimates may vary considerably from the December 31, 2020 assumptions.

Liability for Credit Losses on Unfunded Loan Commitments

The liability for credit losses inherent in unfunded loan commitments is included in Accrued Expenses and Other Liabilities on the Consolidated Statements of Financial Condition. The following table shows the changes in the liability for credit losses on unfunded loan commitments for each of the three years ended December 31.

(Dollars in thousands)	**2020**	2019	2018
Balance, beginning of year	**$ 3,172**	$ 3,075	$ 3,050
Impact of ASC 326 adoption	**777**	—	—
Adjusted balance, beginning of year	**3,949**	3,075	3,050
Provision (recovery of provision)	**550**	97	25
Balance, end of year	**$ 4,499**	$ 3,172	$ 3,075

Note 6 — Lease Investments

As a lessor, the Company's loan and lease portfolio includes direct finance leases, which are included in commercial and agricultural, auto and light truck, medium and heavy duty truck, aircraft, and construction equipment on the Consolidated Statements of Financial Condition. The Company also finances various types of construction equipment, medium and heavy duty trucks, automobiles and other equipment under leases classified as operating leases, which are included in Equipment Owned Under Operating Leases, net, on the Consolidated Statements of Financial Condition.

The following table shows the components of the investment in direct finance and operating leases as of December 31.

(Dollars in thousands)	**2020**	2019
Direct finance leases:		
Minimum lease payments	**$ 160,508**	$ 190,879
Estimated unguaranteed residual values	**—**	41
Less: Unearned income	**(21,507)**	(30,568)
Net investment in direct finance leases	**$ 139,001**	$ 160,352
Operating leases:		
Gross investment in operating leases	**$ 116,818**	$ 176,485
Accumulated depreciation	**(51,778)**	(64,801)
Net investment in operating leases	**$ 65,040**	$ 111,684

The following table shows future minimum lease payments due from clients on direct finance and operating leases at December 31, 2020.

(Dollars in thousands)	Direct Finance Leases	Operating Leases
2021	$ 34,123	$ 16,784
2022	31,867	12,995
2023	29,791	7,676
2024	18,042	3,859
2025	14,822	1,636
Thereafter	31,863	242
Total	**$ 160,508**	**$ 43,192**

To mitigate the risk of loss, the Company seeks to diversify both the type of equipment leased and the industries in which the lessees participate. In addition, a portion of our leases are terminal rental adjustment clause or "TRAC" leases where the lessee effectively guarantees the full residual value through a rental adjustment at the end of term or those where partial value is guaranteed ("split-TRAC"), which has a limited residual risk. Under a split-TRAC structure, the limited residual risk would be satisfied first by the net sale proceeds of the leased asset. The lessee's at-risk portion, or top risk, is satisfied last and is subject to repayment as additional rent, if the TRAC amount is not satisfied by the net sale proceeds. The carrying amount of residual assets covered by residual value guarantees was $43.65 million and $69.09 million at December 31, 2020 and December 31, 2019, respectively.

The following table shows interest income recognized from direct finance lease payments and operating lease equipment rental income and related depreciation expense.

(Dollars in thousands)	**2020**	2019	2018
Direct finance leases:			
Interest income on lease receivable	**$ 8,258**	$ 10,985	$ 13,052
Operating leases:			
Income related to lease payments	**$ 23,380**	$ 30,741	$ 31,793
Depreciation expense	**20,203**	25,128	26,248

Income related to reimbursements from lessees for personal property tax on operating leased equipment for the years ended December 31, 2020 and December 31, 2019 were $0.61 million and $0.73 million. respectively. Expense related to personal property tax payments on operating leased equipment for the year ended December 31, 2020 and December 31, 2019 were $0.61 million and $0.73 million, respectively.

During the year ended December 31, 2020, the Company recorded impairment charges of $0.68 million. The impairment charges were recorded as a result of the annual review of operating lease residual values and was recognized in Depreciation - Leased Equipment on the Consolidated Statements of Income.

Note 7 — Premises and Equipment

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

(Dollars in thousands)	**2020**	2019
Land	**$ 15,505**	$ 15,222
Buildings and improvements	**60,488**	59,508
Furniture and equipment	**42,672**	41,831
Total premises and equipment	**118,665**	116,561
Accumulated depreciation and amortization	**(69,292)**	(64,342)
Net premises and equipment	**$ 49,373**	$ 52,219

Depreciation and amortization of properties and equipment totaled $5.67 million in 2020, $5.79 million in 2019, and $5.62 million in 2018.

During 2020, 2019 and 2018, the Company recorded long-lived asset impairment charges totaling zero, zero and $100,000, respectively. The impairment charges were recorded as a result of appraisals on buildings and were recognized in Other Expense on the Consolidated Statements of Income.

Note 8 — Mortgage Servicing Rights

The unpaid principal balance of residential mortgage loans serviced for third parties was $838.45 million at December 31, 2020, compared to $740.91 million at December 31, 2019, and $734.30 million at December 31, 2018.

Amortization expense on MSRs is expected to total $1.39 million, $1.02 million, $0.72 million, $0.49 million, and $0.34 million in 2021, 2022, 2023, 2024, and 2025, respectively. Projected amortization excludes the impact of future asset additions or disposals.

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

(Dollars in thousands)	**2020**	2019
Mortgage servicing rights:		
Balance at beginning of year	**$ 4,200**	$ 4,283
Additions	**2,777**	1,229
Amortization	**(2,361)**	(1,312)
Sales	**—**	—
Carrying value before valuation allowance at end of year	**4,616**	4,200
Valuation allowance:		
Balance at beginning of year	**—**	—
Impairment charges	**(812)**	—
Balance at end of year	**$ (812)**	$ —
Net carrying value of mortgage servicing rights at end of year	**$ 3,804**	$ 4,200
Fair value of mortgage servicing rights at end of year	**$ 4,038**	$ 5,986

At December 31, 2020, the fair value of MSRs exceeded the carrying value reported on the Consolidated Statements of Financial Condition by $0.23 million. This difference represents increases in the fair value of certain MSRs that could not be recorded above cost basis.

Funds held in trust at 1st Source for the payment of principal, interest, taxes and insurance premiums applicable to mortgage loans being serviced for others, were approximately $17.78 million and $16.77 million at December 31, 2020 and December 31, 2019, respectively. Mortgage loan contractual servicing fees, including late fees and ancillary income, were $3.13 million, $2.64 million, and $2.61 million for 2020, 2019, and 2018, respectively. Mortgage loan contractual servicing fees are included in Mortgage Banking Income on the Consolidated Statements of Income.

Note 9 — Intangible Assets and Goodwill

At December 31, 2020, intangible assets consisted of goodwill of $83.87 million and other intangible assets of $0.08 million, which was net of accumulated amortization of $0.06 million. At December 31, 2019, intangible assets consisted of goodwill of $83.87 million and other intangible assets of $0.10 million, which was net of accumulated amortization of $0.10 million. Intangible asset amortization was $0.02 million, $0.03 million, and $0.08 million for 2020, 2019, and 2018, respectively. Amortization on other intangible assets is expected to total $0.02 million, $0.02 million, $0.02 million, $0.02 million, and $0.00 million in 2021, 2022, 2023, 2024, and 2025, respectively.

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

(Dollars in thousands)	**2020**	2019
Other intangibles:		
Gross carrying amount	**$ 146**	$ 204
Less: accumulated amortization	**(64)**	(100)
Net carrying amount	**$ 82**	$ 104

Note 10 — Deposits

The aggregate amount of certificates of deposit of $250,000 or more and other time deposits of $250,000 or more outstanding at December 31, 2020 and 2019 was $453.16 million and $749.44 million, respectively.

The following table shows the amount of certificates of deposit of $250,000 or more and other time deposits of $250,000 or more outstanding at December 31, 2020, by time remaining until maturity.

(Dollars in thousands)	
Under 3 months	$ 117,444
4 – 6 months	83,262
7 – 12 months	80,237
Over 12 months	172,214
Total	**$ 453,157**

The following table shows scheduled maturities of time deposits, including both private and public funds, at December 31, 2020.

(Dollars in thousands)	
2021	$ 834,723
2022	170,270
2023	108,353
2024	41,353
2025	7,789
Thereafter	4,869
Total	**$ 1,167,357**

Note 11 — Borrowed Funds and Mandatorily Redeemable Securities

The following table shows the details of long-term debt and mandatorily redeemable securities as of December 31, 2020 and 2019.

(Dollars in thousands)	**2020**	2019
Federal Home Loan Bank borrowings (0.54% – 5.04%)	**$ 55,183**	$ 45,819
Mandatorily redeemable securities	**20,358**	17,972
Other long-term debt	**6,323**	7,848
Total long-term debt and mandatorily redeemable securities	**$ 81,864**	$ 71,639

Annual maturities of long-term debt outstanding at December 31, 2020, for the next five years and thereafter beginning in 2021, are as follows (in thousands): $3,168; $4,830; $2,049; $11,187; $145; and $60,485.

At December 31, 2020, the Federal Home Loan Bank borrowings represented a source of funding for community economic development activities, agricultural loans and general funding for the bank and consisted of 18 fixed rate notes with maturities ranging from 2021 to 2030. These notes were collateralized by $68.95 million of certain real estate loans.

Mandatorily redeemable securities as of December 31, 2020 and 2019, of $20.36 million and $17.97 million, respectively reflected the "book value" shares under the 1st Source Executive Incentive Plan. See Note 16 - Stock Based Compensation (Stock Award Plans) for additional information. Dividends paid on these shares and changes in book value per share are recorded as Other interest expense on the Consolidated Statements of Income. Total interest expense recorded for 2020, 2019, and 2018 was $2.14 million, $2.22 million, and $1.61 million, respectively.

The following table shows the details of short-term borrowings as of December 31, 2020 and 2019.

	2020		2019	
(Dollars in thousands)	**Amount**	**Weighted Average Rate**	Amount	Weighted Average Rate
Federal funds purchased	**$ —**	**— %**	$ —	— %
Security repurchase agreements	**143,564**	**0.08**	120,459	0.23
Commercial paper	**4,766**	**0.13**	3,993	0.29
Federal Home Loan Bank advances	**—**	**—**	20,000	1.61
Other short-term borrowings	**2,311**	**—**	1,441	—
Total short-term borrowings	**$ 150,641**	**0.08 %**	$ 145,893	0.42 %

Note 12 — Variable Interest Entities

A variable interest entity (VIE) is a partnership, limited liability company, trust or other legal entity that meets any one of the following criteria:

- The entity does not have sufficient equity to conduct its activities without additional subordinated financial support from another party.
- The entity's investors lack the power to direct the activities that most significantly affect the entity's economic performance.
- The entity's at-risk holders do not have the obligation to absorb the losses or the right to receive residual returns.
- The voting rights of some investors are not proportional to their economic interests in the entity, and substantially all of the entity's activities involve, or are conducted on behalf of, investors with disproportionately few voting rights.

The Company is involved in various entities that are considered to be VIEs. The Company's investments in VIEs are primarily related to investments promoting affordable housing, community development and renewable energy sources. Some of these tax-advantaged investments support the Company's regulatory compliance with the Community Reinvestment Act. The Company's investments in these entities generate a return primarily through the realization of federal and state income tax credits, and other tax benefits, such as tax deductions from operating losses of the investments, over specified time periods. These tax credits are recognized as a reduction of tax expense or, for investments qualifying as investment tax credits, as a reduction to the related investment asset. The Company recognized federal and state income tax credits related to its affordable housing and community development tax-advantaged investments in tax expense of $1.72 million, $1.55 million and $1.29 million for the years ended December 31, 2020, 2019 and 2018, respectively. The Company also recognized $31.08 million, $15.86 million and $10.45 million of investment tax credits for the years ended December 31, 2020, 2019 and 2018, respectively.

The Company is not required to consolidate VIEs in which it has concluded it does not have a controlling financial interest, and thus is not the primary beneficiary. In such cases, the Company does not have both the power to direct the entities' most significant activities and the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIEs. As a limited partner in these operating partnerships, we are allocated credits and deductions associated with the underlying properties. The Company has determined that it is not the primary beneficiary of these investments because the general partners have the power to direct activities that most significantly influence the economic performance of their respective partnerships.

The Company's investments in these unconsolidated VIEs are carried in Other Assets on the Consolidated Statements of Financial Condition. The Company's unfunded capital and other commitments related to these unconsolidated VIEs are generally carried in Other Liabilities on the Consolidated Statements of Financial Condition. The Company's maximum exposure to loss from these unconsolidated VIEs include the investment recorded on the Consolidated Statements of Financial Condition, net of unfunded capital commitments, and previously recorded tax credits which remain subject to recapture by taxing authorities based on compliance features required to be met at the project level. While the Company believes potential losses from these investments are remote, the maximum exposure was determined by assuming a scenario where the community-based business, housing projects and renewable energy projects completely fail and do not meet certain taxing authority compliance requirements resulting in recapture of the related tax credits.

The following table provides a summary of investments in affordable housing, community development and renewable energy VIEs that the Company has not consolidated as of December 31, 2020 and 2019.

(Dollars in thousands)	**2020**	2019
Investment carrying amount	**$ 22,742**	$ 19,843
Unfunded capital and other commitments	**26,716**	17,420
Maximum exposure to loss	**52,106**	37,904

The Company is required to consolidate VIEs in which it has concluded it has significant involvement in and the ability to direct the activities that impact the entity's economic performance. The Company is the managing general partner of entities to which it shares interest in tax-advantaged investments with a third party. At December 31, 2020 and 2019, approximately $53.61 million and $41.24 million, respectively, of the Company's assets and $4.93 million and $18.68 million, respectively, of its liabilities included on the Consolidated Statements of Financial Condition were related to tax-advantaged investment VIEs which the Company has consolidated. The assets of the consolidated VIE are reported in Other Assets, the liabilities are reported in Other Liabilities and the non-controlling interest is reported in Equity on the Consolidated Statements of Financial Condition. The assets of a particular VIE are the primary source of funds to settle its obligations. The creditors of the VIE do not have recourse to the general credit of the Company. The Company's exposure to the consolidated VIE is generally limited to the carrying value of its variable interest plus any related tax credits previously recognized.

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

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

The following table shows subordinated notes at December 31, 2020.

(Dollars in thousands)	Amount of Subordinated Notes	Interest Rate	Maturity Date
June 2007 issuance (1)	$ 41,238	7.22 %	6/15/2037
August 2007 issuance (2)	17,526	1.70 %	9/15/2037
Total	**$ 58,764**		

(1) Fixed rate through life of debt.
(2) 3-Month LIBOR +1.48% through remaining life of debt.

Note 13 — Earnings Per Share

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

Stock options, where the exercise price was greater than the average market price of the common shares, were excluded from the computation of diluted earnings per common share because the result would have been antidilutive. No stock options were considered antidilutive as of December 31, 2020, 2019 and 2018.

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

(Dollars in thousands - except per share amounts)	**2020**	2019	2018
Distributed earnings allocated to common stock	**$ 28,859**	$ 28,188	$ 24,894
Undistributed earnings allocated to common stock	**52,044**	63,254	56,975
Net earnings allocated to common stock	**80,903**	91,442	81,869
Net earnings allocated to participating securities	**534**	518	545
Net income allocated to common stock and participating securities	**$ 81,437**	$ 91,960	$ 82,414
Weighted average shares outstanding for basic earnings per common share	**25,527,154**	25,600,138	25,937,599
Dilutive effect of stock compensation	**—**	—	—
Weighted average shares outstanding for diluted earnings per common share	**25,527,154**	25,600,138	25,937,599
Basic earnings per common share	**$ 3.17**	$ 3.57	$ 3.16
Diluted earnings per common share	**$ 3.17**	$ 3.57	$ 3.16

Note 14 — Accumulated Other Comprehensive Income

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

(Dollars in thousands)	**2020**	2019	**Affected Line Item in the Statements of Income**
Realized gains included in net income	**$ 279**	$ —	Gains (losses) on investment securities available-for-sale
	279	—	Income before income taxes
Tax effect	**(65)**	—	Income tax expense
Net of tax	**$ 214**	$ —	Net income

Note 15 — Employee Benefit Plans

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

Employees are eligible to participate in the Plan the first of the month following 90 days of employment. The Company matches dollar for dollar on the first 4% of deferred compensation, plus 50 cents on the dollar of the next 2% deferrals. The Company will also contribute to the Plan an amount designated as a fixed 2% employer contribution. The amount of fixed contribution is equal to two percent of the participant's eligible compensation. Additionally, each year the Company may, in its sole discretion, make a discretionary profit sharing contribution. As of December 31, 2020 and 2019, there were 824,466 and 852,128 shares, respectively, of 1st Source Corporation common stock held in relation to employee benefit plans.

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

Contribution expense for the years ended December 31, 2020, 2019, and 2018, amounted to $5.70 million, $5.48 million, and $4.87 million, respectively.

Note 16 — Stock Based Compensation

As of December 31, 2020, the Company had four active stock-based employee compensation plans. These plans include three executive stock award plans, the Executive Incentive Plan (EIP), the Restricted Stock Award Plan (RSAP), the Strategic Deployment Incentive Plan (SDP); and the Employee Stock Purchase Plan (ESPP). The 2011 Stock Option Plan was approved by the shareholders on April 21, 2011 but the Company had not made any grants through December 31, 2020. These stock-based employee compensation plans were established to help retain and motivate key employees. All of the plans have been approved by the shareholders of 1st Source Corporation. The Executive Compensation and Human Resources Committee (the "Committee") of the 1st Source Corporation Board of Directors has sole authority to select the employees, establish the awards to be issued, and approve the terms and conditions of each award under the stock-based compensation plans.

Stock-based compensation to employees is recognized as compensation cost on the Consolidated Statements of Income based on their fair values on the measurement date, which, for 1st Source, is the date of grant. Stock-based compensation expense is recognized ratably over the requisite service period for all awards. The total fair value of share awards vested was $2.67 million during 2020, $3.35 million in 2019, and $3.53 million in 2018.

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

		Non-Vested Stock Awards Outstanding	
	Shares Available for Grant	Number of Shares	Weighted-Average Grant-Date Fair Value
Balance, January 1, 2018	676,444	295,926	$ 27.41
Shares authorized - 2018 EIP	70,461	—	—
Granted	(74,981)	74,981	29.11
Stock awards vested	—	(106,513)	25.79
Forfeited	3,135	(10,575)	27.51
Balance, December 31, 2018	675,059	253,819	28.59
Shares authorized - 2019 EIP	62,538	—	—
Granted	(74,336)	74,336	31.44
Stock awards vested	—	(100,299)	28.35
Forfeited	1,241	(8,865)	30.28
Balance, December 31, 2019	664,502	218,991	29.60
Shares authorized - 2020 EIP	**60,233**	**—**	**—**
Granted	**(147,576)**	**147,576**	**37.41**
Stock awards vested	**—**	**(74,203)**	**28.95**
Forfeited	**49**	**(870)**	**31.82**
Balance, December 31, 2020	**577,208**	**291,494**	**$ 33.71**

Stock Option Plans — Incentive stock option plans include the 2011 Stock Option Plan (the “2011 Plan”).

Each award from the plan is evidenced by an award agreement that specifies the option price, the duration of the option, the number of shares to which the option pertains, and such other provisions as the Committee determines. The option price is equal to the fair market value of a share of 1st Source Corporation’s common stock on the date of grant. Options granted expire at such time as the Committee determines at the date of grant and in no event does the exercise period exceed a maximum of ten years. Upon merger, consolidation, or other corporate consolidation in which 1st Source Corporation is not the surviving corporation, as defined in the plans, all outstanding options immediately vest.

There were zero stock options exercised during 2020, 2019 or 2018. All shares issued in connection with stock option exercises and non-vested stock awards are issued from available treasury stock.

No stock-based compensation expense related to stock options was recognized in 2020, 2019 or 2018.

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

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

Stock-based compensation expense relating to the EIP, SDP and RSAP totaled $3.29 million in 2020, $2.76 million in 2019, and $3.55 million in 2018. The total income tax benefit recognized in the accompanying Consolidated Statements of Income related to stock-based compensation was $0.77 million in 2020, $0.65 million in 2019, and $0.86 million in 2018. Unrecognized stock-based compensation expense related to non-vested stock awards (EIP/SDP/RSAP) was $7.63 million at December 31, 2020. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 3.44 years.

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

Employee Stock Purchase Plan — The Company offers an ESPP for substantially all employees with at least two years of service on the effective date of an offering under the plan. Eligible employees may elect to purchase any dollar amount of stock, so long as such amount does not exceed 25% of their base rate of pay and the aggregate stock accrual rate for all offerings does not exceed $25,000 in any calendar year. The purchase price for shares offered is the lower of the closing market bid price for the offering date or the average market bid price for the five business days preceding the offering date. The purchase price and premium/(discount) to the actual market closing price on the offering date for the 2020, 2019, and 2018 offerings were $34.35 (1.78%), $43.81 (0.14%), and $53.84 (-0.09%), respectively. Payment for the stock is made through payroll deductions over the offering period, and employees may discontinue the deductions at any time and exercise the option or take the funds out of the program. The most recent offering began June 1, 2020 and runs through June 1, 2022, with $304,635 in stock value to be purchased at $34.35 per share.

Note 17 — Income Taxes

The following table shows the composition of income tax expense.

Year Ended December 31 ***(Dollars in thousands)***	**2020**	2019	2018
Current:			
Federal	**$ 42,411**	$ 28,130	$ 20,167
State	**6,629**	5,739	2,996
Total current	**49,040**	33,869	23,163
Deferred:			
Federal	**(21,865)**	(5,135)	(875)
State	**(2,295)**	(595)	1,200
Deferred tax liability remeasurement	—	—	(875)
Total deferred	**(24,160)**	(5,730)	(550)
Total provision	**$ 24,880**	$ 28,139	$ 22,613

The following table shows the reasons for the difference between income tax expense and the amount computed by applying the statutory federal income tax rate (21%) to income before income taxes.

	2020		2019		2018	
Year Ended December 31 ***(Dollars in thousands)***	**Amount**	**Percent of Pretax Income**	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Statutory federal income tax	**$ 22,332**	**21.0 %**	$ 25,232	21.0 %	$ 22,056	21.0 %
(Decrease) increase in income taxes resulting from:						
Tax-exempt interest income	**(439)**	**(0.4)**	(552)	(0.5)	(650)	(0.6)
State taxes, net of federal income tax benefit	**3,424**	**3.2**	4,064	3.4	3,315	3.2
Deferred tax liability remeasurement	—	—	—	—	(875)	(0.8)
Other	**(437)**	**(0.4)**	(605)	(0.5)	(1,233)	(1.3)
Total	**$ 24,880**	**23.4 %**	$ 28,139	23.4 %	$ 22,613	21.5 %

The tax expense related to gains (losses) on investment securities available-for-sale for the years 2020, 2019, and 2018 was approximately $67,000, $0, and $(83,000), respectively.

The following table shows the composition of deferred tax assets and liabilities as of December 31, 2020 and 2019.

(Dollars in thousands)	**2020**	2019
Deferred tax assets:		
Allowance for credit losses	**$ 35,696**	$ 28,792
Tax credit carryforward	**8,606**	—
Operating lease liability	**5,704**	5,899
Accruals for employee benefits	**2,963**	2,842
Capitalized loan costs	**893**	—
Mortgage servicing	**173**	—
Other	**678**	222
Total deferred tax assets	**54,713**	37,755
Deferred tax liabilities:		
Differing depreciable bases in premises and leased equipment	**13,118**	18,614
Right of use assets - leases	**5,737**	5,899
Differing bases in assets related to acquisitions	**4,160**	4,092
Tax advantaged partnerships	**3,770**	4,383
Net unrealized gains on securities available-for-sale	**5,827**	1,640
Mortgage servicing	**—**	394
Capitalized loan costs	**—**	1,207
Prepaid expenses	**334**	297
Other	**300**	544
Total deferred tax liabilities	**33,246**	37,070
Net deferred tax asset	**$ 21,467**	$ 685

No valuation allowance for deferred tax assets was recorded at December 31, 2020 and 2019 as the Company believes it is more likely than not that all of the deferred tax assets will be realized. Additionally, the tax credit carryforward expires in 2040.

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

(Dollars in thousands)	**2020**	2019	2018
Balance, beginning of year	**$ —**	$ —	$ 1,112
Additions based on tax positions related to the current year	**—**	—	—
Additions for tax positions of prior years	**—**	—	—
Reductions for tax positions of prior years	**—**	—	—
Reductions due to lapse in statute of limitations	**—**	—	—
Settlements	**—**	—	(1,112)
Balance, end of year	**$ —**	$ —	$ —

The total amount of unrecognized tax benefits that would affect the effective tax rate if recognized was zero at December 31, 2020, 2019 and 2018. Interest and penalties are recognized through the income tax provision. For the years 2020, 2019 and 2018, the Company recognized approximately $0.00 million, $0.00 million and $(0.09) million in interest, net of tax effect, and penalties, respectively. There were no accrued interest and penalties at December 31, 2020, 2019 and 2018.

Tax years that remain open and subject to audit include the federal 2017-2020 years and the Indiana 2017-2020 years. Additionally, in 2018 the Company reached a state tax settlement for the 2015-2017 years and as a result, recorded a reduction of unrecognized tax benefits in the amount of $1.11 million. The Company does not anticipate a significant change in the amount of uncertain tax positions within the next 12 months.

The *Tax Cuts and Jobs Act* was enacted on December 22, 2017. The Act reduced the U.S. federal corporate tax rate from 35% to 21%. At December 31, 2017, the Company had not fully completed its accounting for the tax effects of enactment of the Act and recorded a provisional benefit of $2.61 million which is included as a component of Income Tax Expense on the Consolidated Statements of Income related to the remeasurement of its deferred tax balance. During the third quarter of 2018, the Company completed its accounting for the provisional amounts recognized at December 31, 2017 and recorded an additional $0.88 million benefit as provided by the SEC's Staff Accounting Bulletin No. 118*,* Income Tax Accounting Implications of the *Tax Cuts and Jobs Act*.

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

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

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

The Company's liability for repurchases, included in Accrued Expenses and Other Liabilities on the Consolidated Statements of Financial Condition, was $0.33 million and $0.29 million as of December 31, 2020 and 2019, respectively. The mortgage repurchase liability represents the Company's best estimate of the loss that it may incur. The estimate is based on specific loan repurchase requests and a historical loss ratio with respect to origination dollar volume. Because the level of mortgage loan repurchase losses are dependent on economic factors, investor demand strategies and other external conditions that may change over the life of the underlying loans, the level of liability for mortgage loan repurchase losses is difficult to estimate and requires considerable management judgment.

Lease Commitments — The Company and its subsidiaries are obligated under operating leases for certain office premises and equipment.

The following table shows operating lease right of use assets and operating lease liabilities as of December 31.

(Dollars in thousands)	**Statement of Financial Condition classification**	**2020**	2019
Operating lease right of use assets	Accrued income and other assets	$ 23,825	$ 24,147
Operating lease liabilities	Accrued expenses and other liabilities	$ 23,688	$ 24,319

During 2019, the Company amended the lease agreement for its corporate office building by extending the lease term which resulted in an increase to its operating lease right of use assets of $14.65 million and an increase to its operating lease liabilities of $14.64 million.

The following table shows the components of operating leases expense for the year ended December 31.

(Dollars in thousands)	**Statement of Income classification**	**2020**	2019
Operating lease cost	Net occupancy expense	$ 3,472	$ 3,487
Short-term lease cost	Net occupancy expense	8	41
Variable lease (recovery of) cost	Net occupancy expense	(30)	—
Total operating lease cost		**$ 3,450**	$ 3,528

Gross rental expense for the year ended December 31, 2018 was $3.73 million.

The following table shows future minimum rental commitments for all noncancellable operating leases with an initial term longer than 12 months for the next five years and thereafter.

(Dollars in thousands)	
2021	$ 3,639
2022	3,944
2023	3,590
2024	2,681
2025	2,497
Thereafter	9,194
Total lease payments	25,545
Less: imputed interest	(1,857)
Present value of operating lease liabilities	**$ 23,688**

The following table shows the weighted average remaining operating lease term, the weighted average discount rate and supplemental Consolidated Statement of Cash Flows information for operating leases at December 31.

(Dollars in thousands)	**2020**	2019
Weighted average remaining lease term	**10.17 years**	10.88 years
Weighted average discount rate	**1.80 %**	2.83 %
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	**$ 3,794**	$ 3,768

During the year ended December 31, 2019, the Company recognized a net gain on the sale of an office building in the amount of $1.31 million. The Company commenced an operating lease with the buyer of the building to lease a portion of it for office space resulting in a new right of use asset and operating lease liability.

There were no new significant leases that had not yet commenced as of December 31, 2020.

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

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

(Dollars in thousands)	**2020**	2019
Amounts of commitments:		
Loan commitments to extend credit	**$ 1,140,892**	$ 1,095,054
Standby letters of credit	**$ 24,884**	$ 27,549
Commercial and similar letters of credit	**$ 7,095**	$ 2,332

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

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

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

Commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party. Commercial letters of credit generally have terms ranging from two months to six months.

Note 19 — Derivative Financial Instruments

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

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

The following table shows the amounts of non-hedging derivative financial instruments at December 31, 2020 and 2019.

		Asset derivatives		Liability derivatives	
(Dollars in thousands)	Notional or contractual amount	Statement of Financial Condition classification	Fair value	Statement of Financial Condition classification	Fair value
Interest rate swap contracts	**$ 1,155,252**	Other assets	**$ 46,654**	Other liabilities	**$ 47,681**
Loan commitments	**32,588**	Mortgages held for sale	**1,487**	N/A	—
Forward contracts - mortgage loan	**38,310**	N/A	—	Mortgages held for sale	**290**
Total - December 31, 2020	**$ 1,226,150**		**$ 48,141**		**$ 47,971**
Interest rate swap contracts	$ 1,074,809	Other assets	$ 21,975	Other liabilities	$ 22,352
Loan commitments	9,950	Mortgages held for sale	185	N/A	—
Forward contracts - mortgage loan	23,632	N/A	—	Mortgages held for sale	38
Total - December 31, 2019	$ 1,108,391		$ 22,160		$ 22,390

The following table shows the amounts included on the Consolidated Statements of Income for non-hedging derivative financial instruments at December 31, 2020, 2019 and 2018.

		Gain (loss)		
(Dollars in thousands)	Statement of Income classification	**2020**	2019	2018
Interest rate swap contracts	Other expense	**$ (650)**	$ (252)	$ (30)
Interest rate swap contracts	Other income	**879**	1,356	1,028
Loan commitments	Mortgage banking	**1,302**	73	46
Forward contracts - mortgage loan	Mortgage banking	**(252)**	97	(125)
Total		**$ 1,279**	$ 1,274	$ 919

The following table shows the offsetting of financial assets and derivative assets at December 31, 2020 and 2019.

				Gross Amounts Not Offset in the Statement of Financial Condition		
(Dollars in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Condition	Net Amounts of Assets Presented in the Statement of Financial Condition	Financial Instruments	Cash Collateral Received	Net Amount
December 31, 2020						
Interest rate swaps	**$ 52,872**	**$ 6,218**	**$ 46,654**	**$ —**	**$ —**	**$ 46,654**
December 31, 2019						
Interest rate swaps	$ 22,279	$ 304	$ 21,975	$ —	$ —	$ 21,975

The following table shows the offsetting of financial liabilities and derivative liabilities at December 31, 2020 and 2019.

				Gross Amounts Not Offset in the Statement of Financial Condition		
(Dollars in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Condition	Net Amounts of Liabilities Presented in the Statement of Financial Condition	Financial Instruments	Cash Collateral Pledged	Net Amount
December 31, 2020						
Interest rate swaps	**$ 53,899**	**$ 6,218**	**$ 47,681**	**$ 46,978**	**$ —**	**$ 703**
Repurchase agreements	**143,564**	**—**	**143,564**	**143,564**	**—**	**—**
Total	**$ 197,463**	**$ 6,218**	**$ 191,245**	**$ 190,542**	**$ —**	**$ 703**
December 31, 2019						
Interest rate swaps	$ 22,656	$ 304	$ 22,352	$ 23,482	$ —	$ (1,130)
Repurchase agreements	120,459	—	120,459	120,459	—	—
Total	$ 143,115	$ 304	$ 142,811	$ 143,941	$ —	$ (1,130)

If a default in performance of any obligation of a repurchase or derivative agreement occurs, each party will set-off property held, or loan indebtedness owing, in respect of transactions against obligations owing in respect of any other transactions. At December 31, 2020 and December 31, 2019, repurchase agreements had a remaining contractual maturity of $141.42 million and $119.45 million in overnight and $2.14 million and $1.01 million in up to 30 days, respectively and were collateralized by U.S. Treasury and Federal agencies securities.

Note 20 — Regulatory Matters

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

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

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

As discussed in Note 12, the capital securities held by the Capital Trusts qualify as Tier 1 capital under Federal Reserve Board guidelines. The following table shows the actual and required capital amounts and ratios for 1st Source Corporation and 1st Source Bank as of December 31, 2020 and 2019.

	Actual		Minimum Capital Adequacy		Minimum Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
2020								
Total Capital (to Risk-Weighted Assets):								
1st Source Corporation	**$ 966,092**	**15.99 %**	**$ 483,350**	**8.00 %**	**$634,397**	**10.50 %**	**$ 604,188**	**10.00 %**
1st Source Bank	**881,983**	**14.59**	**483,637**	**8.00**	**634,774**	**10.50**	**604,546**	**10.00**
Tier 1 Capital (to Risk-Weighted Assets):								
1st Source Corporation	**889,709**	**14.73**	**362,513**	**6.00**	**513,560**	**8.50**	**483,350**	**8.00**
1st Source Bank	**805,556**	**13.32**	**362,728**	**6.00**	**513,864**	**8.50**	**483,637**	**8.00**
Common Equity Tier 1 Capital (to Risk-Weighted Assets):								
1st Source Corporation	**788,884**	**13.06**	**271,884**	**4.50**	**422,931**	**7.00**	**392,722**	**6.50**
1st Source Bank	**761,731**	**12.60**	**272,046**	**4.50**	**423,182**	**7.00**	**392,955**	**6.50**
Tier 1 Capital (to Average Assets):								
1st Source Corporation	**889,709**	**12.15**	**292,977**	**4.00**	**N/A**	**N/A**	**366,221**	**5.00**
1st Source Bank	**805,556**	**11.00**	**292,959**	**4.00**	**N/A**	**N/A**	**366,199**	**5.00**
2019								
Total Capital (to Risk-Weighted Assets):								
1st Source Corporation	$ 882,453	14.90 %	$ 473,782	8.00 %	$621,839	10.50 %	$ 592,227	10.00 %
1st Source Bank	804,131	13.57	474,189	8.00	622,373	10.50	592,736	10.00
Tier 1 Capital (to Risk-Weighted Assets):								
1st Source Corporation	807,926	13.64	355,336	6.00	503,393	8.50	473,782	8.00
1st Source Bank	729,541	12.31	355,642	6.00	503,826	8.50	474,189	8.00
Common Equity Tier 1 Capital (to Risk-Weighted Assets):								
1st Source Corporation	743,467	12.55	266,502	4.50	414,559	7.00	384,948	6.50
1st Source Bank	722,082	12.18	266,731	4.50	414,915	7.00	385,279	6.50
Tier 1 Capital (to Average Assets):								
1st Source Corporation	807,926	12.19	265,122	4.00	N/A	N/A	331,402	5.00
1st Source Bank	729,541	11.03	264,500	4.00	N/A	N/A	330,625	5.00

The Bank was not required to maintain noninterest bearing cash balances with the Federal Reserve Bank as of December 31, 2020 and 2019.

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

Due to the Company's mortgage activities, 1st Source Bank is required to maintain minimum net worth capital requirements established by various governmental agencies. 1st Source Bank's net worth requirements are governed by the Department of Housing and Urban Development and GNMA. As of December 31, 2020, 1st Source Bank met its minimum net worth capital requirements.

Note 21 — Fair Value Measurements

The Company determines the fair values of its financial instruments based on the fair value hierarchy, which requires an entity to maximize the use of quoted prices and observable inputs and to minimize the use of unobservable inputs when measuring fair value. The Company elected fair value accounting for mortgages held for sale and for its best-efforts forward sales commitments. The Company economically hedges its mortgages held for sale at the time the interest rate locks are issued to the customers. The Company believes the election for mortgages held for sale will reduce certain timing differences and better match changes in the value of these assets with changes in the value of the derivatives or best-efforts forward sales commitments. At December 31, 2020 and 2019, all mortgages held for sale are carried at fair value.

The following table shows the differences between fair value carrying amount of mortgages held for sale measured at fair value and the aggregate unpaid principal amount the Company is contractually entitled to receive at maturity on December 31, 2020 and 2019.

(Dollars in thousands)	Fair value carrying amount	Aggregate unpaid principal	Excess of fair value carrying amount over (under) unpaid principal
December 31, 2020			
Mortgages held for sale reported at fair value:			
Total Loans	**$ 12,885**	**$ 11,045**	**$ 1,840 (1)**
December 31, 2019			
Mortgages held for sale reported at fair value:			
Total Loans	$ 20,277	$ 19,890	$ 387 (1)

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

Financial Instruments on Recurring Basis:

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

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

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

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

- U.S. treasuries are priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.
- Government-sponsored agency debt securities and corporate bonds are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings and matrix pricing.
- Other government-sponsored agency securities, mortgage-backed securities and some of the actively traded REMICs and CMOs, are primarily priced using available market information including benchmark yields, prepayment speeds, spreads and volatility of similar securities.
- Inactively traded government-sponsored agency securities are primarily priced using consensus pricing and dealer quotes.
- State and political subdivisions are largely grouped by characteristics, i.e., geographical data and source of revenue in trade dissemination systems. Since some securities are not traded daily and due to other grouping limitations, active market quotes are often obtained using benchmarking for like securities. Local direct placement municipal securities, with very little market activity, are priced using an appropriate market yield curve which incorporates a credit spread assumption.

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

Interest rate swap positions, both assets and liabilities, are valued by a third-party pricing agent using an income approach and utilizing models that use as their basis readily observable market parameters. This valuation process considers various factors including interest rate yield curves, time value and volatility factors. Validation of third-party agent valuations is accomplished by comparing those values to the Company's swap counterparty valuations. Management believes an adjustment is required to "mid-market" valuations for derivatives tied to its performing loan portfolio to recognize the imprecision and related exposure inherent in the process of estimating expected credit losses as well as velocity of deterioration evident with systemic risks embedded in these portfolios. Any change in the mid-market derivative valuation adjustment will be recognized immediately through the Consolidated Statements of Income.

The following table shows the balance of assets and liabilities measured at fair value on a recurring basis.

(Dollars in thousands)	Level 1	Level 2	Level 3	Total
December 31, 2020				
Assets:				
Investment securities available-for-sale:				
U.S. Treasury and Federal agencies securities	**$ 80,285**	**$ 539,197**	**$ —**	**$ 619,482**
U.S. States and political subdivisions securities	**—**	**78,975**	**2,152**	**81,127**
Mortgage-backed securities - Federal agencies	**—**	**453,789**	**—**	**453,789**
Corporate debt securities	**—**	**42,369**	**—**	**42,369**
Foreign government securities	**—**	**700**	**—**	**700**
Total debt securities available-for-sale	**80,285**	**1,115,030**	**2,152**	**1,197,467**
Mortgages held for sale	**—**	**12,885**	**—**	**12,885**
Accrued income and other assets (interest rate swap agreements)	**—**	**46,654**	**—**	**46,654**
Total	**$ 80,285**	**$ 1,174,569**	**$ 2,152**	**$ 1,257,006**
Liabilities:				
Accrued expenses and other liabilities (interest rate swap agreements)	**$ —**	**$ 47,681**	**$ —**	**$ 47,681**
Total	**$ —**	**$ 47,681**	**$ —**	**$ 47,681**
December 31, 2019				
Assets:				
Investment securities available-for-sale:				
U.S. Treasury and Federal agencies securities	$ 80,393	$ 446,571	$ —	$ 526,964
U.S. States and political subdivisions securities	—	82,213	2,292	84,505
Mortgage-backed securities - Federal agencies	—	375,389	—	375,389
Corporate debt securities	—	53,025	—	53,025
Foreign government securities	—	700	—	700
Total debt securities available-for-sale	80,393	957,898	2,292	1,040,583
Mortgages held for sale	—	20,277	—	20,277
Accrued income and other assets (interest rate swap agreements)	—	21,975	—	21,975
Total	$ 80,393	$ 1,000,150	$ 2,292	$ 1,082,835
Liabilities:				
Accrued expenses and other liabilities (interest rate swap agreements)	$ —	$ 22,352	$ —	$ 22,352
Total	$ —	$ 22,352	$ —	$ 22,352

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

(Dollars in thousands)		U.S. States and political subdivisions securities
Beginning balance January 1, 2020	**$**	**2,292**
Total gains or losses (realized/unrealized):		
Included in earnings		**—**
Included in other comprehensive income		**58**
Purchases		**3,100**
Issuances		**—**
Sales		**—**
Settlements		**—**
Maturities		**(3,298)**
Transfers into Level 3		**—**
Transfers out of Level 3		**—**
Ending balance December 31, 2020	**$**	**2,152**
Beginning balance January 1, 2019	$	1,025
Total gains or losses (realized/unrealized):		
Included in earnings		—
Included in other comprehensive income		(35)
Purchases		5,600
Issuances		—
Sales		—
Settlements		—
Maturities		(4,298)
Transfers into Level 3		—
Transfers out of Level 3		—
Ending balance December 31, 2019	$	2,292

There were no gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at December 31, 2020 or 2019.

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

(Dollars in thousands)		Fair value	Valuation Methodology	Unobservable Inputs	Range of Inputs	Weighted Average
December 31, 2020						
Debt securities available-for-sale						
Direct placement municipal securities	**$**	**2,152**	**Discounted cash flows**	**Credit spread assumption**	**0.04% - 2.30%**	**1.55 %**
December 31, 2019						
Debt securities available-for-sale						
Direct placement municipal securities	$	2,292	Discounted cash flows	Credit spread assumption	0.12% - 2.85%	

Financial Instruments on Non-recurring Basis:

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

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

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

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

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

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

For assets measured at fair value on a nonrecurring basis the following represents impairment charges (recoveries) recognized on these assets during the year ended December 31, 2020 and 2019, respectively: collateral-dependent impaired loans - $7.73 million and $4.29 million; MSRs - $0.81 million and $0.00 million; repossessions - $1.07 million and $2.25 million, and other real estate - $0.00 million and $0.00 million.

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

(Dollars in thousands)	Level 1	Level 2	Level 3	Total
December 31, 2020				
Collateral-dependent impaired loans	**$ —**	**$ —**	**$ 11,991**	**$ 11,991**
Accrued income and other assets (mortgage servicing rights)	**—**	**—**	**3,804**	**3,804**
Accrued income and other assets (repossessions)	**—**	**—**	**1,976**	**1,976**
Accrued income and other assets (other real estate)	**—**	**—**	**359**	**359**
Total	**$ —**	**$ —**	**$ 18,130**	**$ 18,130**
December 31, 2019				
Collateral-dependent impaired loans	$ —	$ —	$ 8,492	$ 8,492
Accrued income and other assets (mortgage servicing rights)	—	—	4,200	4,200
Accrued income and other assets (repossessions)	—	—	8,623	8,623
Accrued income and other assets (other real estate)	—	—	522	522
Total	$ —	$ —	$ 21,837	$ 21,837

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

(Dollars in thousands)	Carrying Value	Fair Value	Valuation Methodology	Unobservable Inputs	Range of Inputs	Weighted Average
December 31, 2020						
Collateral-dependent impaired loans	**$ 11,991**	**$ 11,991**	**Collateral based measurements including appraisals, trade publications, and auction values**	**Discount for lack of marketability and current conditions**	**0% - 100%**	**43.7 %**
Mortgage servicing rights	**3,804**	**4,038**	**Discounted cash flows**	**Constant prepayment rate (CPR)**	**16.2% - 30.5%**	**22.8 %**
				Discount rate	**8.3% - 11.1%**	**8.5 %**
Repossessions	**1,976**	**2,144**	**Appraisals, trade publications and auction values**	**Discount for lack of marketability**	**0% - 16%**	**8 %**
Other real estate	**359**	**388**	**Appraisals**	**Discount for lack of marketability**	**6% - 13%**	**7 %**
December 31, 2019						
Collateral-dependent impaired loans	$ 8,492	$ 8,492	Collateral based measurements including appraisals, trade publications, and auction values	Discount for lack of marketability and current conditions	0% - 90%	
Mortgage servicing rights	4,200	5,986	Discounted cash flows	Constant prepayment rate (CPR)	10.2% - 28.1%	
				Discount rate	9.3% - 12.1%	
Repossessions	8,623	9,211	Appraisals, trade publications and auction values	Discount for lack of marketability	3% - 25%	
Other real estate	522	564	Appraisals	Discount for lack of marketability	0% - 11%	

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.

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

(Dollars in thousands)	Carrying or Contract Value	Fair Value	Level 1	Level 2	Level 3
December 31, 2020					
Assets:					
Cash and due from banks	**$ 74,186**	**$ 74,186**	**$ 74,186**	**$ —**	**$ —**
Federal funds sold and interest bearing deposits with other banks	**168,861**	**168,861**	**168,861**	**—**	**—**
Investment securities, available-for-sale	**1,197,467**	**1,197,467**	**80,285**	**1,115,030**	**2,152**
Other investments	**27,429**	**27,429**	**27,429**	**—**	**—**
Mortgages held for sale	**12,885**	**12,885**	**—**	**12,885**	**—**
Loans and leases, net of allowance for loan and lease losses	**5,348,647**	**5,417,396**	**—**	**—**	**5,417,396**
Mortgage servicing rights	**3,804**	**4,038**	**—**	**—**	**4,038**
Accrued interest receivable	**20,242**	**20,242**	**—**	**20,242**	**—**
Interest rate swaps	**46,654**	**46,654**	**—**	**46,654**	**—**
Liabilities:					
Deposits	**$ 5,946,028**	**$ 5,955,545**	**$ 4,778,671**	**$ 1,176,874**	**$ —**
Short-term borrowings	**150,641**	**150,641**	**143,730**	**6,911**	**—**
Long-term debt and mandatorily redeemable securities	**81,864**	**82,965**	**—**	**82,965**	**—**
Subordinated notes	**58,764**	**58,560**	**—**	**58,560**	**—**
Accrued interest payable	**3,996**	**3,996**	**—**	**3,996**	**—**
Interest rate swaps	**47,681**	**47,681**	**—**	**47,681**	**—**
Off-balance-sheet instruments *	**—**	**321**	**—**	**321**	**—**
December 31, 2019					
Assets:					
Cash and due from banks	$ 67,215	$ 67,215	$ 67,215	$ —	$ —
Federal funds sold and interest bearing deposits with other banks	16,150	16,150	16,150	—	—
Investment securities, available-for-sale	1,040,583	1,040,583	80,393	957,898	2,292
Other investments	28,414	28,414	28,414	—	—
Mortgages held for sale	20,277	20,277	—	20,277	—
Loans and leases, net of allowance for loan and lease losses	4,974,273	4,992,684	—	—	4,992,684
Mortgage servicing rights	4,200	5,986	—	—	5,986
Accrued interest receivable	19,125	19,125	—	19,125	—
Interest rate swaps	21,975	21,975	—	21,975	—
Liabilities:					
Deposits	$ 5,357,326	$ 5,362,633	$ 3,708,828	$ 1,653,805	$ —
Short-term borrowings	145,893	145,893	120,891	25,002	—
Long-term debt and mandatorily redeemable securities	71,639	71,084	—	71,084	—
Subordinated notes	58,764	61,469	—	61,469	—
Accrued interest payable	13,918	13,918	—	13,918	—
Interest rate swaps	22,352	22,352	—	22,352	—
Off-balance-sheet instruments *	—	281	—	281	—

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

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

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

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

STATEMENTS OF FINANCIAL CONDITION

December 31 ***(Dollars in thousands)***	**2020**	2019
ASSETS		
Cash and cash equivalents	**$ 113,242**	$ 107,285
Short-term investments with bank subsidiary	**500**	500
Investments in:		
Bank subsidiaries	**858,993**	806,192
Non-bank subsidiaries	**1**	1
Right of use assets	**17,452**	17,106
Other assets	**5,251**	4,442
Total assets	**$ 995,439**	$ 935,526
LIABILITIES AND SHAREHOLDERS' EQUITY		
Commercial paper	**$ 4,767**	$ 3,993
Long-term debt and mandatorily redeemable securities	**26,681**	25,819
Subordinated notes	**58,764**	58,764
Operating lease liability	**17,369**	17,329
Other liabilities	**1,013**	1,344
Total liabilities	**108,594**	107,249
Total shareholders' equity	**886,845**	828,277
Total liabilities and shareholders' equity	**$ 995,439**	$ 935,526

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Year Ended December 31 ***(Dollars in thousands)***	**2020**	2019	2018
Income:			
Dividends from bank subsidiary	**$ 46,207**	$ 46,735	$ 45,080
Rental (reimbursements to) income from subsidiaries	**(908)**	2,505	2,613
Other	**293**	366	367
Investment securities and other investment (losses) gains	**(44)**	109	(180)
Total income	**45,548**	49,715	47,880
Expenses:			
Interest on subordinated notes	**3,367**	3,677	3,625
Interest on long-term debt and mandatorily redeemable securities	**2,151**	2,228	1,624
Interest on commercial paper and other short-term borrowings	**11**	13	14
Occupancy	**1,816**	1,861	1,774
Other	**667**	586	642
Total expenses	**8,012**	8,365	7,679
Income before income tax benefit and equity in undistributed income of subsidiaries	**37,536**	41,350	40,201
Income tax benefit	**1,747**	987	1,009
Income before equity in undistributed income of subsidiaries	**39,283**	42,337	41,210
Equity in undistributed income of subsidiaries:			
Bank subsidiaries	**42,178**	49,678	41,204
Net income	**$ 81,461**	$ 92,015	$ 82,414
Comprehensive income	**$ 94,660**	$ 107,863	$ 75,788

STATEMENTS OF CASH FLOWS

Year Ended December 31 ***(Dollars in thousands)***	**2020**	2019	2018
Operating activities:			
Net income	**$ 81,461**	$ 92,015	$ 82,414
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity (undistributed) distributed in excess of income of subsidiaries	**(42,178)**	(49,678)	(41,204)
Depreciation of premises and equipment	**2**	2	2
Amortization of right of use assets	**1,107**	1,350	—
Stock-based compensation	**94**	78	71
Realized/unrealized investment securities and other investment losses (gains)	**44**	(109)	180
Other	**(103)**	533	45
Net change in operating activities	**40,427**	44,191	41,508
Investing activities:			
Net change in partnership investments	**(182)**	(260)	(980)
Capital contribution to subsidiary	—	(325)	—
Net change in investing activities	**(182)**	(585)	(980)
Financing activities:			
Net change in commercial paper	**774**	(332)	(1,790)
Proceeds from issuance of long-term debt and mandatorily redeemable securities	**1,640**	1,611	1,867
Payments on long-term debt and mandatorily redeemable securities	**(2,268)**	(2,068)	(1,064)
Stock issued under stock purchase plans	**39**	49	145
Net proceeds from issuance of treasury stock	**1,706**	1,878	1,763
Acquisition of treasury stock	**(6,415)**	(15,085)	(9,271)
Cash dividends paid on common stock	**(29,764)**	(29,021)	(25,686)
Net change in financing activities	**(34,288)**	(42,968)	(34,036)
Net change in cash and cash equivalents	**5,957**	638	6,492
Cash and cash equivalents, beginning of year	**107,285**	106,647	100,155
Cash and cash equivalents, end of year	**$ 113,242**	$ 107,285	$ 106,647

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

None

Item 9A. Controls and Procedures.

1st Source carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, at December 31, 2020, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by 1st Source in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

In addition, there were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the fourth fiscal quarter of 2020 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

1st Source's management assessed the effectiveness of internal control over financial reporting as of December 31, 2020. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework* (2013 framework). Based on management's assessment, 1st Source believes that, as of December 31, 2020, 1st Source's internal control over financial reporting is effective based on those criteria.

BKD LLP, independent registered public accounting firm, has issued an attestation report on management's assessment of 1st Source's internal control over financial reporting. This report appears on page 44.

By /s/ CHRISTOPHER J. MURPHY III

Christopher J. Murphy III, Chief Executive Officer

By /s/ ANDREA G. SHORT

Andrea G. Short, Treasurer and Chief Financial Officer

South Bend, Indiana

Item 9B. Other Information.

None

Part III

Item 10. Directors, Executive Officers and Corporate Governance.

The information under the caption “Proposal Number 1: Election of Directors,” “Board Committees and Other Corporate Governance Matters,” and “Delinquent Section 16(a) Reports” of the 2021 Proxy Statement is incorporated herein by reference.

Item 11. Executive Compensation.

The information under the caption “Compensation Discussion & Analysis” of the 2021 Proxy Statement is incorporated herein by reference.

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

The information under the caption “Voting Securities and Principal Holders Thereof” and “Proposal Number 1: Election of Directors” of the 2021 Proxy Statement is incorporated herein by reference.

The following table shows Equity Compensation Plan Information as of December 31, 2020.

	(A) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans [excluding securities reflected in column (A)]	
Equity compensation plans approved by shareholders				
2011 Stock Option Plan	—	$ —	250,000	
1997 Employee Stock Purchase Plan	11,793	36.69	113,049	
1982 Executive Incentive Plan	—	—	58,693	(1)(2)
1982 Restricted Stock Award Plan	—	—	169,870	(1)
Strategic Deployment Incentive Plan	—	—	98,645	(1)(2)
Total plans approved by shareholders	**11,793**	**$ —**	**690,257**	
Equity compensation plans not approved by shareholders				
Director Retainer Stock Plan	—	—	16,546	
Total equity compensation plans	**11,793**	**$ —**	**706,803**	

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

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

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

The information under the caption “Proposal Number 1: Election of Directors”, “Board Committees and Other Corporate Governance Matters, “ and “Transactions with Related Persons” of the 2021 Proxy Statement is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

The information under the caption “Relationship with Independent Registered Public Accounting Firm” of the 2021 Proxy Statement is incorporated herein by reference.

Part IV

Item 15. Exhibits and Financial Statement Schedules.

(a) Financial Statements and Schedules:

The following Financial Statements and Supplementary Data are filed as part of this annual report:

Reports of Independent Registered Public Accounting Firm

Consolidated Statements of Financial Condition — December 31, 2020 and 2019

Consolidated Statements of Income — Years ended December 31, 2020, 2019, and 2018

Consolidated Statements of Comprehensive Income — Years ended December 31, 2020, 2019, and 2018

Consolidated Statements of Shareholders' Equity — Years ended December 31, 2020, 2019, and 2018

Consolidated Statements of Cash Flows — Years ended December 31, 2020, 2019, and 2018

Notes to Consolidated Financial Statements — December 31, 2020, 2019, and 2018

Financial statement schedules required by Article 9 of Regulation S-X are not required under the related instructions, or are inapplicable and, therefore, have been omitted.

(b) Exhibits (numbered in accordance with Item 601 of Regulation S-K):

3(a)	Articles of Incorporation of Registrant, amended April 30, 1996, filed as exhibit to Form 10-K, dated December 31, 2017, and incorporated herein by reference.
3(b)	By-Laws of Registrant, as amended March 20, 2020, filed as an exhibit to Form 10-Q, dated March 31, 2020, and incorporated herein by reference.
3(c)	Certificate of Designations for Series A Preferred Stock, dated January 23, 2009, filed as exhibit to Form 8-K, dated January 23, 2009, and incorporated herein by reference.
4(a)	Form of Common Stock Certificates of Registrant, filed as exhibit to Registration Statement 2-40481 and incorporated herein by reference.
4(b)	1st Source agrees to furnish to the Commission, upon request, a copy of each instrument defining the rights of holders of Senior and Subordinated debt of 1st Source.
10(a)(1)	Employment Agreement of Christopher J. Murphy III, dated January 1, 2008, filed as exhibit to Form 8-K, dated March 17, 2008, amended February 6, 2014, filed as exhibit to Form 8-K, dated March 12, 2014, and incorporated herein by reference.
10(a)(2)	Employment Agreement of Andrea G. Short dated January 1, 2013, filed as exhibit to Form 10-K, dated December 31, 2012, amended February 6, 2014, filed as exhibit to Form 8-K, dated March 12, 2014, and incorporated herein by reference.
10(a)(3)	Employment Agreement of John B. Griffith, dated January 1, 2008, filed as exhibit to Form 8-K, dated March 17, 2008, amended February 6, 2014, filed as exhibit to Form 8-K, dated March 12, 2014, and incorporated herein by reference.
10(a)(4)	Employment Agreement of Jeffrey L. Buhr, dated May 23, 2017, filed as an exhibit to Form 8-K, dated May 23, 2017, and incorporated herein by reference.
10(b)	1st Source Corporation Employee Stock Purchase Plan dated April 17, 1997, filed as exhibit to Form 10-K, dated December 31, 2017, and incorporated herein by reference.
10(c)	1st Source Corporation 1982 Executive Incentive Plan, amended November 9, 2016, filed as an exhibit to Form 10-K, dated December 31, 2016, and incorporated herein by reference.
10(d)	1st Source Corporation 1982 Restricted Stock Award Plan, amended November 9, 2016, filed as Exhibit 4.3 to Registration Statement on Form S-8 No. 333-215910, filed February 6, 2017, and incorporated herein by reference.
10(e)	1st Source Corporation Strategic Deployment Incentive Plan, amended February 26, 2016, filed as exhibit to registrant's 2016 definitive proxy statement, filed March 15, 2016, and incorporated herein by reference.
10(f)	1st Source Corporation 2011 Stock Option Plan, amended November 9, 2016, filed as exhibit to Form 10-K, dated December 31, 2016, and incorporated herein by reference.
10(g)	1st Source Corporation Director Retainer Stock Plan, amended August 3, 2018, filed as exhibit to Form 10-Q, dated September 30, 2018, and incorporated herein by reference.

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

Name	Jurisdiction
1st Source Bank	Indiana
SFG Aircraft, Inc. * (formerly known as SFG Equipment Leasing, Inc.)	Indiana
1st Source Insurance, Inc. *	Indiana
1st Source Specialty Finance, Inc. *	Indiana
1st Source Capital Corporation *	Indiana
Trustcorp Mortgage Company (Inactive)	Indiana
1st Source Master Trust	Delaware
Michigan Transportation Finance Corporation *	Michigan
1st Source Intermediate Holding, LLC	Delaware
1st Source Funding, LLC (Inactive)	Delaware
SFG Commercial Aircraft Leasing, Inc. *	Indiana
SFG Equipment Leasing Corporation I*	Indiana
Washington and Michigan Insurance, Inc.*	Arizona
1st Source Solar 1, LLC*	Delaware
1st Source Solar 2, LLC	Delaware
1st Source Solar 3, LLC	Delaware
1st Source Solar 4, LLC	Delaware
Historic Holding, LLC*	Indiana
1st Source Solar 5, LLC	Delaware
1st Source Solar 6, LLC	Delaware

*Wholly-owned subsidiaries of 1st Source Bank

23	Consent of BKD, LLP, Independent Registered Public Accounting Firm.
31.1	Certification of Christopher J. Murphy III, Chief Executive Officer (Rule 13a-14(a)).
31.2	Certification of Andrea G. Short, Chief Financial Officer (Rule 13a-14(a)).
32.1	Certification of Christopher J. Murphy III, Chief Executive Officer.
32.2	Certification of Andrea G. Short, Chief Financial Officer.
101.INS	XBRL Instance Document — The instance document does not appear in the interactive data file because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL document and included in Exhibit 101)

(c) Financial Statement Schedules — None.

Item 16. Form 10-K Summary.

Not provided.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

1st SOURCE CORPORATION

By /s/ CHRISTOPHER J. MURPHY III

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

Date: February 18, 2021

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

Signature	Title	Date
/s/ CHRISTOPHER J. MURPHY III Christopher J. Murphy III	Chairman of the Board, President and Chief Executive Officer	February 18, 2021
/s/ ANDREA G. SHORT Andrea G. Short	Treasurer, Chief Financial Officer and Principal Accounting Officer	February 18, 2021
/s/ JOHN B. GRIFFITH John B. Griffith	Secretary and General Counsel	February 18, 2021
/s/ JOHN F. AFFLECK-GRAVES John F. Affleck-Graves	Director	February 18, 2021
/s/ MELODY BIRMINGHAM Melody Birmingham	Director	February 18, 2021
/s/ DANIEL B. FITZPATRICK Daniel B. Fitzpatrick	Director	February 18, 2021
/s/ VINOD M. KHILNANI Vinod M. Khilnani	Director	February 18, 2021
/s/ CHRISTOPHER J. MURPHY IV Christopher J. Murphy IV	Director	February 18, 2021
/s/ TIMOTHY K. OZARK Timothy K. Ozark	Director	February 18, 2021
/s/ JOHN T. PHAIR John T. Phair	Director	February 18, 2021
/s/ TODD F. SCHURZ Todd F. Schurz	Director	February 18, 2021
/s/ MARK D. SCHWABERO Mark D. Schwabero	Director	February 18, 2021

EXHIBIT 31.1

Certifications

I, Christopher J. Murphy III, Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of 1st Source Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:
    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 18, 2021

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

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of 1st Source Corporation (1st Source) on Form 10-K for the fiscal year ended December 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Christopher J. Murphy III, Chief Executive Officer of 1st Source, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of sections 13(a) or 15(d) of the Securities and Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of 1st Source.

Date: February 18, 2021

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

EXHIBIT 31.2

Certifications

I, Andrea G. Short, Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of 1st Source Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 18, 2021

By /s/ ANDREA G. SHORT

Andrea G. Short, Chief Financial Officer

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of 1st Source Corporation (1st Source) on Form 10-K for the fiscal year ended December 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Andrea G. Short, Chief Financial Officer of 1st Source, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of sections 13(a) or 15(d) of the Securities and Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of 1st Source.

Date: February 18, 2021

By /s/ ANDREA G. SHORT

Andrea G. Short, Chief Financial Officer

DIRECTORS AND OFFICERS


John F. Affleck-Graves


Melody Birmingham


Daniel B. Fitzpatrick


Tracy D. Graham


Vinod M. Khilnani


Christopher J. Murphy III


Christopher J. Murphy IV


Timothy K. Ozark


John T. Phair


Todd F. Schurz


Mark D. Schwabero


James R. Seitz

1st SOURCE DIRECTORS

		CORP.	BANK
John F. Affleck-Graves	Professor of Finanace, University of Notre Dame	X	X
Melody Birmingham	Senior Vice President and Chief Procurement Officer, Duke Energy	X	X
Daniel B. Fitzpatrick	Chairman and Chief Executive Officer, Quality Dining, Inc.	X	X
Tracy D. Graham	Managing Principal, Graham Allen Partners		X
Vinod M. Khilnani	Chairman of the Board, Materion Corporation	X	X
Christopher J. Murphy III	Chairman and Chief Executive Officer	X	X
Christopher J. Murphy IV	Chief Executive Officer, Catharsis Productions, LLC	X	X
Timothy K. Ozark	Chairman and Chief Executive Officer, Aim Financial Corporation	X	X
John T. Phair	Chairman of the Board, Holladay Properties	X	X
Todd F. Schurz	President and Chief Executive Officer, Schurz Communications, Inc.	X	X
Mark D. Schwabero	Retired Chairman, Chief Executive Officer and Director, Brunswick Corporation	X	X
James R. Seitz	Vice Chairman		X

1st SOURCE EXECUTIVE OFFICERS

		CORP.	BANK
Christopher J. Murphy III	Chairman of the Board and Chief Executive Officer	X	X
Andrea G. Short	Executive Vice President, Treasurer, Chief Financial Officer & President of 1st Source Bank	X	X
Jeffrey L. Buhr	Executive Vice President, Chief Credit Officer		X
John B. Griffith	Executive Vice President, Chief Administration Officer, Secretary and General Counsel	X	X
James R. Seitz	Vice Chairman		X

1st Source Corporation

P.O. Box 1602, South Bend, Indiana 46634

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