1ST SOURCE CORP
Form 10-Q
October 20, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from to

Commission file number 0-6233
(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)

(574) 235-2000
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer x

Non-accelerated filer o
(Do not check if a smaller reporting company)

Smaller reporting company o

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

Number of shares of common stock outstanding as of October 14, 2016 — 25,867,093 shares

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

	September 30, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$ 65,724	$ 65,171
Federal funds sold and interest bearing deposits with other banks	30,100	14,550
Investment securities available-for-sale	828,615	791,727
Other investments	22,458	21,973
Mortgages held for sale	19,986	9,825
Loans and leases, net of unearned discount:		
Commercial and agricultural	786,167	744,749
Auto and light truck	400,809	425,236
Medium and heavy duty truck	271,478	278,254
Aircraft	836,977	778,012
Construction equipment	498,086	455,565
Commercial real estate	744,972	700,268
Residential real estate and home equity	490,186	464,129
Consumer	150,742	148,479
Total loans and leases	4,179,417	3,994,692
Reserve for loan and lease losses	(88,897)	(88,112)
Net loans and leases	4,090,520	3,906,580
Equipment owned under operating leases, net	117,883	110,371
Net premises and equipment	54,654	53,191
Goodwill and intangible assets	84,244	84,676
Accrued income and other assets	133,727	129,852
Total assets	$ 5,447,911	$ 5,187,916
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$ 992,776	$ 902,364
Interest-bearing deposits:		
Interest-bearing demand	1,417,692	1,350,417
Savings	799,891	745,661
Time	1,166,679	1,140,744
Total interest-bearing deposits	3,384,262	3,236,822
Total deposits	4,377,038	4,139,186
Short-term borrowings:		
Federal funds purchased and securities sold under agreements to repurchase	167,029	130,662
Other short-term borrowings	48,978	102,567
Total short-term borrowings	216,007	233,229
Long-term debt and mandatorily redeemable securities	64,760	57,379
Subordinated notes	58,764	58,764
Accrued expenses and other liabilities	61,083	55,305
Total liabilities	4,777,652	4,543,863

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 at September 30, 2016 and December 31, 2015	436,538	436,538
Retained earnings	280,335	251,812
Cost of common stock in treasury (2,338,581 shares at September 30, 2016 and 2,178,090 shares at December 31, 2015)	(56,262)	(50,852)
Accumulated other comprehensive income	9,648	6,555
Total shareholders' equity	670,259	644,053
Total liabilities and shareholders' equity	$ 5,447,911	$ 5,187,916

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest income:				
Loans and leases	$44,965	$ 42,560	$131,592	$ 124,747
Investment securities, taxable	2,384	3,277	8,504	8,929
Investment securities, tax-exempt	672	738	2,061	2,261
Other	279	246	879	730
Total interest income	48,300	46,821	143,036	136,667
Interest expense:				
Deposits	3,879	2,874	11,440	8,271
Short-term borrowings	150	147	430	381
Subordinated notes	1,055	1,055	3,165	3,165
Long-term debt and mandatorily redeemable securities	522	536	1,725	1,540
Total interest expense	5,606	4,612	16,760	13,357
Net interest income	42,694	42,209	126,276	123,310
Provision for loan and lease losses	2,067	992	5,091	2,160
Net interest income after provision for loan and lease losses	40,627	41,217	121,185	121,150
Noninterest income:				
Trust fees	4,691	4,634	14,422	14,438
Service charges on deposit accounts	2,366	2,413	6,749	6,977
Debit card	2,745	2,583	8,160	7,610
Mortgage banking	1,334	969	3,495	3,459
Insurance commissions	1,350	1,460	4,146	4,147
Equipment rental	6,657	5,881	19,247	16,302
Gains on investment securities available-for-sale	989	—	790	4
Other	2,533	3,192	9,580	9,477
Total noninterest income	22,665	21,132	66,589	62,414
Noninterest expense:				
Salaries and employee benefits	22,136	21,835	64,681	63,554
Net occupancy	2,435	2,496	7,243	7,302
Furniture and equipment	4,898	4,604	14,499	13,471
Depreciation - leased equipment	5,570	4,858	16,115	13,342
Professional fees	1,244	1,237	3,653	3,215
Supplies and communication	1,256	1,307	4,138	4,122
FDIC and other insurance	647	848	2,437	2,544
Business development and marketing	1,263	1,244	3,268	3,507
Loan and lease collection and repossession	324	416	1,136	485
Other	1,372	2,223	4,714	5,828
Total noninterest expense	41,145	41,068	121,884	117,370
Income before income taxes	22,147	21,281	65,890	66,194
Income tax expense	7,883	7,353	23,329	23,125
Net income	$14,264	$ 13,928	$42,561	$ 43,069
Per common share:				
Basic net income per common share	$0.55	$ 0.53	$1.63	$ 1.63

Diluted net income per common share	$ 0.55	$ 0.53	$ 1.63	$ 1.63
Cash dividends	$ 0.180	$ 0.164	$ 0.540	$ 0.491
Basic weighted average common shares outstanding	25,867,169	26,164,646	25,881,360	26,211,630
Diluted weighted average common shares outstanding	25,867,169	26,164,646	25,881,360	26,211,630

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

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1st SOURCE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited - Dollars in thousands)

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Net income	$14,264	$13,928	$42,561	$43,069
Other comprehensive (loss) income:				
Change in unrealized (depreciation) appreciation of available-for-sale securities	(905)	2,256	5,742	475
Reclassification adjustment for realized (gains) losses included in net income	(989)	—	(790)	(4)
Income tax effect	711	(847)	(1,859)	(177)
Other comprehensive (loss) income, net of tax	(1,183)	1,409	3,093	294
Comprehensive income	$13,081	$15,337	$45,654	$43,363

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

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

	Preferred Stock	Common Stock	Retained Earnings	Cost of Common Stock in Treasury	Accumulated Other Comprehensive Income (Loss), Net	Total
Balance at January 1, 2015	$ —	$346,535	$302,242	$(43,711)	$ 9,407	$614,473
Net income	—	—	43,069	—	—	43,069
Other comprehensive income	—	—	—	—	294	294
Issuance of 117,122 common shares under stock based compensation awards, including related tax effects	—	—	(252)	2,799	—	2,547
Cost of 283,263 shares of common stock acquired for treasury	—	—	—	(8,208)	—	(8,208)
Common stock cash dividend ($0.491 per share)	—	—	(12,941)	—	—	(12,941)
10% common stock dividend ($13 cash paid in lieu of fractional shares)	—	90,003	(90,016)	—	—	(13)
Balance at September 30, 2015	$ —	$436,538	$242,102	$(49,120)	$ 9,701	$639,221
Balance at January 1, 2016	$ —	$436,538	$251,812	$(50,852)	$ 6,555	$644,053
Net income	—	—	42,561	—	—	42,561
Other comprehensive income	—	—	—	—	3,093	3,093
Issuance of 109,887 common shares under stock based compensation awards, including related tax effects	—	—	(4)	2,620	—	2,616
Cost of 270,378 shares of common stock acquired for treasury	—	—	—	(8,030)	—	(8,030)
Common stock cash dividend ($0.540 per share)	—	—	(14,034)	—	—	(14,034)
Balance at September 30, 2016	$ —	$436,538	$280,335	$(56,262)	$ 9,648	$670,259

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

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

	Nine Months Ended September 30,	
	2016	2015
Operating activities:		
Net income	$42,561	$43,069
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	5,091	2,160
Depreciation of premises and equipment	3,897	3,517
Depreciation of equipment owned and leased to others	16,115	13,342
Stock-based compensation	2,036	2,953
Amortization of investment securities premiums and accretion of discounts, net	4,594	3,433
Amortization of mortgage servicing rights	1,133	1,117
Deferred income taxes	82	(3,914)
Gains on investment securities available-for-sale	(790)	(4)
Originations of loans held for sale, net of principal collected	(88,161)	(90,381)
Proceeds from the sales of loans held for sale	80,474	97,402
Net gain on sale of loans held for sale	(2,474)	(2,604)
Net gain on sale of other real estate and repossessions	(154)	(818)
Change in trading account securities	—	205
Change in interest receivable	(1,204)	(666)
Change in interest payable	1,089	312
Change in other assets	7	(4,802)
Change in other liabilities	4,820	5,068
Other	(367)	1,200
Net change in operating activities	68,749	70,589
Investing activities:		
Proceeds from sales of investment securities available-for-sale	5,139	1,299
Proceeds from maturities and paydowns of investment securities available-for-sale	158,178	78,033
Purchases of investment securities available-for-sale	(199,056)	(75,757)
Net change in other investments	(485)	(927)
Loans sold or participated to others	—	1,962
Net change in loans and leases	(191,881)	(276,108)
Net change in equipment owned under operating leases	(23,627)	(34,984)
Purchases of premises and equipment	(5,532)	(4,612)
Proceeds from sales of other real estate and repossessions	1,523	6,788
Net change in investing activities	(255,741)	(304,306)
Financing activities:		
Net change in demand deposits and savings accounts	211,917	140,737
Net change in time deposits	25,935	75,559
Net change in short-term borrowings	(17,222)	37,688
Proceeds from issuance of long-term debt	10,837	—
Payments on long-term debt	(5,928)	(924)
Stock issued under stock purchase plans	116	149
Acquisition of treasury stock	(8,030)	(8,208)
Cash dividends paid on common stock	(14,530)	(13,285)

Net change in financing activities	203,095	231,716
Net change in cash and cash equivalents	16,103	(2,001)
Cash and cash equivalents, beginning of year	79,721	66,190
Cash and cash equivalents, end of period	$95,824	$64,189
Supplemental Information:		
Non-cash transactions:		
Loans transferred to other real estate and repossessed assets	$2,850	$7,558
Common stock matching contribution to Employee Stock Ownership and Profit Sharing Plan	800	500

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

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

Basis of Presentation – The accompanying unaudited consolidated financial statements reflect all adjustments (all of which are normal and recurring in nature) which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position, the results of operations, changes in comprehensive income, changes in shareholders’ equity, and cash flows for the periods presented. These unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been omitted.

The Notes to the Consolidated Financial Statements appearing in 1st Source Corporation’s Annual Report on Form 10-K (2015 Annual Report), which include descriptions of significant accounting policies, should be read in conjunction with these interim financial statements. The Consolidated Statement of Financial Condition at December 31, 2015 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. Certain amounts in the prior period consolidated financial statements have been reclassified to conform to the current year presentation.

Use of Estimates in the Preparation of Financial Statements – Financial statements prepared in accordance with 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 expense during the reporting period. Actual results could differ from those estimates.

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.

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

A loan or lease is considered impaired, based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan or lease agreement. Interest on impaired loans and leases, which are not classified as nonaccrual, is recognized on the accrual basis. The Company evaluates loans and leases exceeding $100,000 for impairment and establishes a specific reserve as a component of the reserve for loan and lease losses when it is probable all amounts due will not be collected pursuant to the contractual terms of the loan or lease and the recorded investment in the loan or lease exceeds its fair value.

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

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

Note 2. Recent Accounting Pronouncements

Classification of Certain Cash Receipts and Cash Payments: In August 2016, the Financial Accounting Standards Board (FASB)issued Accounting Standards Update (ASU) No. 2016-15 “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments.” ASU 2016-15 provides cash flow statement classification guidance for certain transactions including how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied retrospectively. Early adoption is permitted, including adoption in an interim period. The Company is assessing ASU 2016-15 but does not expect a significant 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.” 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.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense.

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.

ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of ASU 2016-13 on its accounting and disclosures.

Share Based Payment Accounting: In March 2016, the FASB issued ASU No. 2016-09 “Compensation - Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment Accounting.” ASU 2016-09 requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee’s shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election for forfeitures as they occur. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted. The Company continues to assess ASU 2016-09 but does not expect a significant impact on its accounting and disclosures.

Leases: In February 2016, the FASB issued ASU No. 2016-02 “Leases (Topic 842).” ASU 2016-02 establishes a right of use model that requires a lessee to record a right of use asset and a lease liability for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. A lease will be treated as sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, with certain practical expedients available. Early adoption is permitted. The Company continues to assess the impact of ASU 2016-02 on its accounting and disclosures.

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Recognition and Measurement of Financial Instruments: In January 2016, the FASB issued ASU No. 2016-01 "Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 is intended to improve the recognition and measurement of financial instruments by requiring equity investments to be measured at fair value with changes in fair value recognized in net income; requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured and amortized at cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. The Company continues to assess the impact of ASU 2016-01 on its accounting and disclosures.
Short Duration Contracts: In May 2015, the FASB issued ASU No. 2015-09 "Financial Services - Insurance (Topic 944) - Disclosures about Short Duration Contracts." ASU 2015-09 includes amendments that require insurance entities to disclose for annual reporting periods information about the liability for unpaid claims and claim adjustment expenses as well as significant changes in methodologies and assumptions used to calculate the liability for unpaid claims and claim adjustment expenses. In addition, the amendments require a roll-forward of the liability for unpaid claims and claim adjustment expenses on an annual and interim basis. The amendments are effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016 and should be applied retrospectively. Early adoption is permitted. The Company has determined that ASU 2015-09 applies to certain insurance lines of business but is not expected to have a material impact on its disclosures.
Consolidations: In February 2015, the FASB issued ASU No. 2015-02 "Consolidation (Topic 810) - Amendments to the Consolidation Analysis." ASU 2015-02 includes amendments that are intended to improve targeted areas of consolidation for legal entities including reducing the number of consolidation models from four to two and simplifying the FASB Accounting Standards Codification. ASU 2015-02 is effective for annual and interim periods within those annual periods, beginning after December 15, 2015. The amendments may be applied retrospectively in previously issued financial statements for one or more years with a cumulative effect adjustment to retained earnings as of the beginning of the first year restated. Early adoption is permitted, including adoption in an interim period. The Company adopted ASU 2015-02 on January 1, 2016 and it did not have an impact on its accounting and disclosures.
Revenue from Contracts with Customers: In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. In March 2016, the FASB issued final amendments (ASU No. 2016-08 and ASU No. 2016-10) to clarify the implementation guidance for principal versus agent considerations, identifying performance obligations and the accounting for licenses of intellectual property. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. In May 2016, the FASB issued final amendments (ASU No. 2016-12 and ASU 2016-11) to address narrow-scope improvements to the guidance on collectibility, non-cash consideration, completed contracts at transition and to provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales

taxes and other similar taxes collected from customers. Additionally, the amendments included a rescission of SEC guidance because of ASU 2014-09 related to revenue and expense recognition for freight services in process, accounting for shipping and handling fees and costs, and accounting for consideration given by a vendor to a customer. These amendments are effective upon the adoption of ASU 2014-09. The Company continues to assess the impact of ASU 2014-09 on its accounting and disclosures.

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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
September 30, 2016				
U.S. Treasury and Federal agencies securities	$405,726	$ 2,328	$ (59)	$407,995
U.S. States and political subdivisions securities	130,386	2,590	(147)	132,829
Mortgage-backed securities — Federal agencies	239,486	4,884	(200)	244,170
Corporate debt securities	35,342	288	(15)	35,615
Foreign government and other securities	800	10	—	810
Total debt securities	811,740	10,100	(421)	821,419
Marketable equity securities	1,428	5,779	(11)	7,196
Total investment securities available-for-sale	$813,168	$ 15,879	$ (432)	$828,615
December 31, 2015				
U.S. Treasury and Federal agencies securities	$389,457	$ 1,718	$ (1,506)	$389,669
U.S. States and political subdivisions securities	120,441	2,692	(143)	122,990
Mortgage-backed securities — Federal agencies	234,400	3,430	(1,533)	236,297
Corporate debt securities	34,241	199	(57)	34,383
Foreign government and other securities	800	10	(1)	809
Total debt securities	779,339	8,049	(3,240)	784,148
Marketable equity securities	1,893	5,906	(220)	7,579
Total investment securities available-for-sale	$781,232	$ 13,955	$ (3,460)	$791,727

At September 30, 2016 and December 31, 2015, the residential mortgage-backed securities held by the Company consisted primarily of GNMA, FNMA and FHLMC pass-through certificates which are guaranteed by those respective agencies of the United States government (Government Sponsored Enterprise, GSEs).

The following table shows the contractual maturities of investments in debt securities available-for-sale at September 30, 2016. 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	$ 212,850	$213,454
Due after one year through five years	320,672	324,588
Due after five years through ten years	38,732	39,207
Due after ten years	—	—
Mortgage-backed securities	239,486	244,170
Total debt securities available-for-sale	$ 811,740	$821,419

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

(Dollars in thousands)	Less than 12 Months		12 months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2016						
U.S. Treasury and Federal agencies securities	$ 31,409	$ (59)	$ —	$ —	$ 31,409	$ (59)
U.S. States and political subdivisions securities	24,850	(108)	2,692	(39)	27,542	(147)
Mortgage-backed securities - Federal agencies	48,311	(159)	4,995	(41)	53,306	(200)
Corporate debt securities	4,992	(15)	—	—	4,992	(15)
Foreign government and other securities	—	—	—	—	—	—
Total debt securities	109,562	(341)	7,687	(80)	117,249	(421)
Marketable equity securities	340	(10)	3	(1)	343	(11)
Total investment securities available-for-sale	$ 109,902	$ (351)	$ 7,690	$ (81)	$ 117,592	$ (432)
December 31, 2015						
U.S. Treasury and Federal agencies securities	$ 151,581	$ (928)	$ 43,372	$ (578)	$ 194,953	$ (1,506)
U.S. States and political subdivisions securities	17,040	(79)	3,795	(64)	20,835	(143)
Mortgage-backed securities - Federal agencies	78,731	(777)	20,592	(756)	99,323	(1,533)
Corporate debt securities	9,340	(57)	—	—	9,340	(57)
Foreign government and other securities	99	(1)	—	—	99	(1)
Total debt securities	256,791	(1,842)	67,759	(1,398)	324,550	(3,240)
Marketable equity securities	427	(218)	3	(2)	430	(220)
Total investment securities available-for-sale	$ 257,218	$ (2,060)	$ 67,762	$ (1,400)	$ 324,980	$ (3,460)

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

At September 30, 2016, the Company does not have the intent to sell any of the available-for-sale securities in the table above and believes that it is more likely than not, that it will not have to sell any such securities before an anticipated recovery of cost. Primarily the unrealized losses on debt securities are due to increases in market rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover on all debt securities as they approach their maturity date or re-pricing date or if market yields for such investments decline. The Company does not believe any of the securities are impaired due to reasons of credit quality.

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

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Gross realized gains	$ 989	$ —	$ 1,084	$ 4
Gross realized losses	—	—	—	—
OTTI losses	—	—	(294)	—

Net realized gains (losses)	$ 989	$ —	$790	$ 4

At September 30, 2016 and December 31, 2015, investment securities available-for-sale with carrying values of $258.35 million and $233.14 million, respectively, were pledged as collateral for security repurchase agreements and for other purposes.

Note 4. Loan and Lease Financings

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 the Company’s safety and soundness. Loans or leases graded 7 or weaker are considered “special attention” credits and, as such, relationships in excess of $100,000 are reviewed quarterly as part of management’s evaluation of the appropriateness of the reserve for loan and lease losses. Grade 7 credits are defined as “watch” and contain greater than average credit risk and are monitored to limit the exposure to increased risk; grade 8 credits are “special mention” and, following regulatory guidelines, are defined as having potential weaknesses that deserve management’s close attention. Credits that exhibit well-defined weaknesses and a distinct possibility of loss are considered “classified” and are graded 9 through 12 corresponding to the regulatory definitions of “substandard” (grades 9 and 10) and the more severe “doubtful” (grade 11) and “loss” (grade 12).

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

	Credit Quality Grades		
(Dollars in thousands)	1-6	7-12	Total
September 30, 2016			
Commercial and agricultural	$758,615	$27,552	$786,167
Auto and light truck	396,001	4,808	400,809
Medium and heavy duty truck	270,255	1,223	271,478
Aircraft	809,233	27,744	836,977
Construction equipment	492,309	5,777	498,086
Commercial real estate	735,076	9,896	744,972
Total	$3,461,489	$77,000	$3,538,489
December 31, 2015			
Commercial and agricultural	$710,030	$34,719	$744,749
Auto and light truck	413,836	11,400	425,236
Medium and heavy duty truck	275,367	2,887	278,254
Aircraft	750,264	27,748	778,012
Construction equipment	448,683	6,882	455,565
Commercial real estate	680,304	19,964	700,268
Total	$3,278,484	$103,600	$3,382,084

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. The following table shows the recorded investment in residential real estate and home equity and consumer loans by performing or nonperforming status. Nonperforming loans are those loans which are on nonaccrual status or are 90 days or more past due.

(Dollars in thousands)	Performing	Nonperforming	Total
September 30, 2016			
Residential real estate and home equity	$ 488,325	$ 1,861	$490,186
Consumer	149,530	1,212	150,742

Total	$ 637,855	$ 3,073	$ 640,928
December 31, 2015			
Residential real estate and home equity	$ 462,236	$ 1,893	$ 464,129
Consumer	148,180	299	148,479
Total	$ 610,416	$ 2,192	$ 612,608

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

(Dollars in thousands)	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Accruing	Total Accruing Loans	Nonaccrual	Total Financing Receivables
September 30, 2016							
Commercial and agricultural	$782,090	$309	$ —	$ —	$782,399	$ 3,768	$786,167
Auto and light truck	400,532	250	—	—	400,782	27	400,809
Medium and heavy duty truck	270,883	595	—	—	271,478	—	271,478
Aircraft	822,620	5,548	—	—	828,168	8,809	836,977
Construction equipment	496,701	305	—	—	497,006	1,080	498,086
Commercial real estate	740,847	299	52	—	741,198	3,774	744,972
Residential real estate and home equity	487,304	460	561	551	488,876	1,310	490,186
Consumer	148,897	522	111	58	149,588	1,154	150,742
Total	$4,149,874	$8,288	$ 724	$ 609	$4,159,495	$ 19,922	$4,179,417
December 31, 2015							
Commercial and agricultural	$740,335	$52	$ 79	$ —	$740,466	$ 4,283	$744,749
Auto and light truck	424,997	170	23	—	425,190	46	425,236
Medium and heavy duty truck	278,254	—	—	—	278,254	—	278,254
Aircraft	764,074	9,442	108	—	773,624	4,388	778,012
Construction equipment	454,993	33	—	—	455,026	539	455,565
Commercial real estate	698,514	362	—	—	698,876	1,392	700,268
Residential real estate and home equity	460,771	1,038	427	71	462,307	1,822	464,129
Consumer	147,419	552	209	51	148,231	248	148,479
Total	$3,969,357	$11,649	$ 846	$ 122	$3,981,974	$ 12,718	$3,994,692

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

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Reserve
September 30, 2016			
With no related reserve recorded:			
Commercial and agricultural	$ 327	$ 327	$ —
Auto and light truck	—	—	—
Medium and heavy duty truck	—	—	—
Aircraft	—	—	—
Construction equipment	429	429	—
Commercial real estate	844	844	—
Residential real estate and home equity	—	—	—
Consumer	—	—	—
Total with no related reserve recorded	1,600	1,600	—
With a reserve recorded:			
Commercial and agricultural	3,188	3,188	767
Auto and light truck	—	—	—
Medium and heavy duty truck	—	—	—
Aircraft	8,809	8,809	1,990
Construction equipment	568	568	128
Commercial real estate	2,809	2,809	361
Residential real estate and home equity	361	363	144
Consumer	—	—	—
Total with a reserve recorded	15,735	15,737	3,390
Total impaired loans	$ 17,335	$ 17,337	$ 3,390
December 31, 2015			
With no related reserve recorded:			
Commercial and agricultural	$ 1,016	$ 1,016	$ —
Auto and light truck	—	—	—
Medium and heavy duty truck	—	—	—
Aircraft	4,384	4,384	—
Construction equipment	539	539	—
Commercial real estate	8,494	8,494	—
Residential real estate and home equity	—	—	—
Consumer	—	—	—
Total with no related reserve recorded	14,433	14,433	—
With a reserve recorded:			
Commercial and agricultural	2,884	2,884	649
Auto and light truck	—	—	—
Medium and heavy duty truck	—	—	—
Aircraft	—	—	—
Construction equipment	—	—	—
Commercial real estate	—	—	—
Residential real estate and home equity	366	368	148
Consumer	—	—	—
Total with a reserve recorded	3,250	3,252	797

Total impaired loans	$ 17,683	$ 17,685	$ 797

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The following table shows average recorded investment and interest income recognized on impaired loans and leases, segregated by class.

(Dollars in thousands)	Three Months Ended September 30, 2016 Average Recorded Investment	Interest Income	2015 Average Recorded Investment	Interest Income	Nine Months Ended September 30, 2016 Average Recorded Investment	Interest Income	2015 Average Recorded Investment	Interest Income
Commercial and agricultural	$3,282	$ 1	$3,882	$ 11	$3,480	$ 5	$5,275	$ 27
Auto and light truck	—	—	—	—	—	—	—	—
Medium and heavy duty truck	—	—	—	—	—	—	—	—
Aircraft	9,051	2	7,422	1	5,806	2	7,945	6
Construction equipment	618	—	738	—	671	—	736	—
Commercial real estate	2,961	—	9,762	108	5,821	123	10,800	392
Residential real estate and home equity	362	4	369	4	364	12	371	12
Consumer	—	—	—	—	—	—	—	—
Total	$16,274	$ 7	$22,173	$ 124	$16,142	$ 142	$25,127	$ 437

There was one nonperforming loan and lease modification classified as a troubled debt restructuring (TDR) during the three and nine months ended September 30, 2016 and two performing loan modifications classified as TDR during the three and nine months ended September 30, 2015. The classification between nonperforming and performing is determined at the time of modification. Modification programs focus on extending maturity dates or modifying payment patterns with most TDRs experiencing a combination of concessions. Modifications do not result in the contractual forgiveness of principal or interest. There was one modification during 2016 and no modifications during 2015 that resulted in an interest rate reduction below market rate. Consequently, the financial impact of the modification was immaterial.

There were no TDRs which had payment defaults within the twelve months following modification during the three and nine months ended September 30, 2016 and 2015. 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 September 30, 2016 and December 31, 2015.

(Dollars in thousands)	September 30, 2016	December 31, 2015
Performing TDRs	$ 361	$ 7,437
Nonperforming TDRs	1,780	1,926
Total TDRs	$ 2,141	$ 9,363

Note 5. Reserve for Loan and Lease Losses

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

Michigan in the business banking and commercial real estate portfolios and by collateral concentration in the specialty finance portfolios and exposure to foreign markets by geographic risk.

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The reserve for loan and lease losses is maintained at a level believed to be appropriate by the Company to absorb probable losses inherent in the loan and lease portfolio. The determination of the reserve requires significant judgment reflecting the Company’s best estimate of probable loan and lease losses related to specifically identified impaired loans and leases as well as probable losses in the remainder of the various loan and lease portfolios. For purposes of determining the reserve, the Company has segmented loans and leases into classes based on the associated risk within these segments. The Company has determined that eight classes exist within the loan and lease portfolio. The methodology for assessing the appropriateness of the reserve consists of several key elements, which include: specific reserves for impaired loans, formula reserves for each business lending division portfolio including percentage allocations for special attention loans and leases not deemed impaired, and reserves for pooled homogeneous loans and leases. The Company’s evaluation is based upon a continuing review of these portfolios, estimates of customer performance, collateral values and dispositions, and assessments of economic and geopolitical events, all of which are subject to judgment and will change.

The following table shows the changes in the reserve for loan and lease losses, segregated by class, for the three months ended September 30, 2016 and 2015.

(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
September 30, 2016									
Balance, beginning of period	$ 14,835	$ 11,667	$ 4,350	$ 34,661	$ 7,512	$ 13,462	$ 3,377	$ 1,594	$ 91,458
Charge-offs	206	1	—	4,834	36	31	55	174	5,337
Recoveries	160	65	—	186	172	48	1	77	709
Net charge-offs (recoveries)	46	(64)	—	4,648	(136)	(17)	54	97	4,628
Provision (recovery of provision)	90	(3,998)	(72)	5,148	286	460	106	47	2,067
Balance, end of period	$ 14,879	$ 7,733	$ 4,278	$ 35,161	$ 7,934	$ 13,939	$ 3,429	$ 1,544	$ 88,897
September 30, 2015									
Balance, beginning of period	$ 11,865	$ 11,445	$ 4,333	$ 32,840	$ 7,807	$ 13,226	$ 3,444	$ 1,628	$ 86,588
Charge-offs	88	—	—	195	—	—	39	310	632
Recoveries	80	64	10	279	112	39	2	82	668
Net charge-offs (recoveries)	8	(64)	(10)	(84)	(112)	(39)	37	228	(36)
Provision (recovery of provision)	2,182	(2,131)	101	1,117	(276)	(244)	(8)	251	992
Balance, end of period	$ 14,039	$ 9,378	$ 4,444	$ 34,041	$ 7,643	$ 13,021	$ 3,399	$ 1,651	$ 87,616

The following table shows the changes in the reserve for loan and lease losses, segregated by class, for the nine months ended September 30, 2016 and 2015.

(Dollars in thousands)	Commercial and agricultural loans	Auto and light truck	Medium and heavy duty truck	Aircraft	Construction equipment	Commercial real estate	Residential real estate and home equity	Consumer loans	Total
September 30, 2016									

Balance, beginning of period	$ 15,456	$ 9,269	$ 4,699	$ 32,373	$ 7,592	$ 13,762	$ 3,382	$ 1,579	$ 88,112
Charge-offs	422	4	—	4,834	128	32	136	676	6,232
Recoveries	360	191	10	412	320	388	7	238	1,926
Net charge-offs (recoveries)	62	(187)	(10)	4,422	(192)	(356)	129	438	4,306
Provision (recovery of provision)	(515)	(1,723)	(431)	7,210	150	(179)	176	403	5,091
Balance, end of period	$ 14,879	$							