PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
May 06, 2016
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 March 31, 2016
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d)
OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the transition period from ____ to ____
Commission File Number: 000-31225

, Inc.
(Exact name of registrant as specified in its charter)

Tennessee	62-1812853
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

150 Third Avenue South, Suite 900, Nashville, Tennessee	37201
(Address of principal executive offices)	(Zip Code)

(615) 744-3700
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changes since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 shorter period that the registrant was required to submit and post such files).
Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	Accelerated Filer
Non-accelerated Filer (do not check if you are a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No
As of May 5, 2016 there were 42,045,184 shares of common stock, $1.00 par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
March 31, 2016

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FORWARD-LOOKING STATEMENTS

Certain of the statements in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words "expect," "anticipate," "goal," "objective," "intend," "plan," "believe," "should," "hope," "pursue," "seek," "estimate" and similar expressions are intended to identify such forward-looking statements, but other statements not based on historical information may also be considered forward-looking. All forward-looking statements are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of Pinnacle Financial to differ materially from any results expressed or implied by such forward-looking statements. Such risks include, without limitation, (i) deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses; (ii) continuation of the historically low short-term interest rate environment; (iii) the inability of Pinnacle Financial, or entities in which it has significant investments, like BHG, to maintain the historical growth rate of its, or such entities', loan portfolio; (iv) changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments; (v) effectiveness of Pinnacle Financial's asset management activities in improving, resolving or liquidating lower-quality assets; (vi) increased competition with other financial institutions; (vii) greater than anticipated adverse conditions in the national or local economies including the Nashville-Davidson-Murfreesboro-Franklin MSA, the Knoxville MSA, the Chattanooga, TN-GA MSA and the Memphis, TN-MS-AR MSA, particularly in commercial and residential real estate markets; (viii) rapid fluctuations or unanticipated changes in interest rates on loans or deposits; (ix) the results of regulatory examinations; (x) the ability to retain large, uninsured deposits; (xi) a merger or acquisition like our proposed merger with Avenue Financial Holdings, Inc. (Avenue); (xii) risks of expansion into new geographic or product markets; (xiii) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including intangible assets; (xiv) reduced ability to attract additional financial advisors (or failure of such advisors to cause their clients to switch to Pinnacle Financial), to retain financial advisors (including those at Avenue) or otherwise to attract customers from other financial institutions; (xv) further deterioration in the valuation of other real estate owned and increased expenses associated therewith; (xvi) inability to comply with regulatory capital requirements, including those resulting from changes to capital calculation methodologies and required capital maintenance levels; (xvii) risks associated with litigation, including the applicability of insurance coverage; (xviii) the risk that the cost savings and any revenue synergies from the mergers with Avenue, CapitalMark Bank & Trust (CapitalMark) and Magna Bank (Magna) may not be realized or take longer than anticipated to be realized; (xix) disruption from the Avenue merger with customers, suppliers or employee relationships; (xx) the occurrence of any event, change or other circumstances that could give rise to the termination of the Avenue merger agreement; (xxi) the risk of successful integration of Avenue's, CapitalMark's and Magna's business with ours; (xxii) the failure of Avenue's shareholders to approve the Avenue merger; (xxiii) the amount of the costs, fees, expenses and charges related to the Avenue merger; (xxiv) the ability to obtain required government approvals of the proposed terms of the Avenue merger; (xxv) risk of adverse reaction of Pinnacle Financial's and Avenue's customers to the Avenue merger; (xxvi) the failure of the closing conditions of the Avenue merger to be satisfied; (xxvii) the risk that the integration of Avenue's, CapitalMark's and Magna's operations with Pinnacle Financial's will be materially delayed or will be more costly or difficult than expected; (xxviii) the possibility that the Avenue merger may be more expensive to complete than anticipated, including as a result of unexpected factors or events; (xxix) the dilution caused by Pinnacle Financial's issuance of additional shares of its common stock in the Avenue merger; (xxx) approval of the declaration of any dividend by Pinnacle Financial's board of directors; (xxxi) the vulnerability of our network and online banking portals to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches; (xxxii) the possibility of increased compliance costs as a result of increased regulatory oversight, including oversight of companies in which Pinnacle Financial has significant investments, and the development of additional banking products for our corporate and consumer clients; (xxxiii) the risks associated with our being a minority investor in BHG, including the risk that the owners of a majority of the membership interests in BHG decide to sell the company if not prohibited from doing so by the terms of our agreement with them; (xxxiv) the incremental cost and/or decreased revenues associated with exceeding $10 billion in assets will exceed current estimates; and (xxxv) changes in state and federal legislation, regulations or policies applicable to banks and other financial service providers, including regulatory or legislative developments. A more detailed description of these and other risks is contained herein and in Pinnacle Financial's most recent annual report on Form 10-K filed with the Securities and Exchange Commission on February 29, 2016. Many of such factors are beyond Pinnacle Financial's ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. Pinnacle Financial disclaims any obligation to update or revise any forward-looking statements contained in this report, whether as a result of new information, future events or otherwise.

Item 1. Part I. Financial Information

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2016	December 31, 2015
ASSETS		
Cash and noninterest-bearing due from banks	$77,778,562	$75,078,807
Interest-bearing due from banks	304,031,806	219,202,464
Federal funds sold and other	767,305	26,670,062
Cash and cash equivalents	382,577,673	320,951,333
Securities available-for-sale, at fair value	1,017,329,867	935,064,745
Securities held-to-maturity (fair value of $31,521,474 and $31,585,303 at March 31, 2016 and December 31, 2015, respectively)	31,089,333	31,376,840
Consumer mortgage loans held-for-sale	35,437,491	47,930,253
Commercial mortgage loans held-for-sale	10,504,481	-
Loans	6,827,929,582	6,543,235,381
Less allowance for loan losses	(62,239,279)	(65,432,354)
Loans, net	6,765,690,303	6,477,803,027
Premises and equipment, net	78,771,705	77,923,607
Equity method investment	203,007,435	88,880,014
Accrued interest receivable	25,168,584	21,574,096
Goodwill	431,840,600	432,232,255
Core deposits and other intangible assets	9,667,282	10,540,497
Other real estate owned	4,687,379	5,083,218
Other assets	265,615,499	265,183,799
Total assets	$9,261,387,632	$8,714,543,684
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$2,026,550,350	$1,889,865,113
Interest-bearing	1,427,213,569	1,389,548,175
Savings and money market accounts	2,958,363,723	3,001,950,725
Time	668,084,583	690,049,795
Total deposits	7,080,212,225	6,971,413,808
Securities sold under agreements to repurchase	62,801,494	79,084,298
Federal Home Loan Bank advances	616,289,980	300,305,226
Subordinated debt and other borrowings	209,751,241	141,605,504
Accrued interest payable	2,540,401	2,593,209
Other liabilities	61,012,450	63,930,339
Total liabilities	8,032,607,791	7,558,932,384
Stockholders' equity:		
Preferred stock, no par value, 10,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, par value $1.00; 90,000,000 shares authorized;		

41,994,955 and 40,906,064 shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively	41,994,955	40,906,064
Additional paid-in capital	884,015,506	839,617,050
Retained earnings	300,746,837	278,573,408
Accumulated other comprehensive income (loss), net of taxes	2,022,543	(3,485,222)
Total stockholders' equity	1,228,779,841	1,155,611,300
Total liabilities and stockholders' equity	$9,261,387,632	$8,714,543,684

See accompanying notes to consolidated financial statements (unaudited).
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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended	
	March 31, 2016	March 31, 2015
Interest income:		
Loans, including fees	$74,404,204	$49,466,706
Securities:		
Taxable	4,466,834	3,444,599
Tax-exempt	1,493,757	1,483,307
Federal funds sold and other	609,587	283,978
Total interest income	80,974,382	54,678,590
Interest expense:		
Deposits	4,915,563	2,430,742
Securities sold under agreements to repurchase	48,050	30,917
Federal Home Loan Bank advances and other borrowings	2,108,092	948,552
Total interest expense	7,071,705	3,410,211
Net interest income	73,902,677	51,268,379
Provision for loan losses	3,893,570	315,091
Net interest income after provision for loan losses	70,009,107	50,953,288
Noninterest income:		
Service charges on deposit accounts	3,442,684	2,912,549
Investment services	2,345,600	2,259,440
Insurance sales commissions	1,705,859	1,512,618
Gain on mortgage loans sold, net	3,567,551	1,941,254
Gain on sale of investment securities, net	-	6,003
Trust fees	1,580,612	1,311,985
Income from equity method investment	5,147,524	3,201,302
Other noninterest income	8,065,880	5,348,151
Total noninterest income	25,855,710	18,493,302
Noninterest expense:		
Salaries and employee benefits	32,516,856	23,530,860
Equipment and occupancy	8,130,464	6,046,223
Other real estate expense	112,272	395,288
Marketing and other business development	1,263,361	959,750
Postage and supplies	957,087	649,251
Amortization of intangibles	873,215	227,414
Merger related expense	1,829,472	-
Other noninterest expense	8,380,969	5,022,236
Total noninterest expense	54,063,696	36,831,022
Income before income taxes	41,801,121	32,615,568
Income tax expense	13,835,857	10,772,857
Net income	$27,965,264	$21,842,711
Per share information:		
Basic net income per common share	$0.70	$0.62

Diluted net income per common share	$0.68	$0.62
Weighted average shares outstanding:		
Basic	40,082,805	35,041,203
Diluted	40,847,027	35,380,529

See accompanying notes to consolidated financial statements (unaudited).

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Net income	$27,965,264	$21,842,711
Other comprehensive income, net of tax:		
Change in fair value on available-for-sale securities, net of tax	6,431,468	1,936,058
Change in fair value of cash flow hedges, net of tax	(923,703)	(552,828)
Net gain on sale of investment securities reclassified from other comprehensive income into net income, net of tax	-	3,648
Total other comprehensive income, net of tax	5,507,765	1,386,878
Total comprehensive income	$33,473,029	$23,229,589

See accompanying notes to consolidated financial statements (unaudited).

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comp. Income, net	Total Stockholders' Equity
	Shares	Amount				
Balance at December 31, 2014	35,732,483	$35,732,483	$561,431,449	$201,371,081	$4,158,368	$802,693,381
Exercise of employee common stock options and related tax benefits	65,270	65,270	2,924,061	-	-	2,989,331
Common dividends paid	-	-	-	(4,304,125)	-	(4,304,125)
Issuance of restricted common shares, net of forfeitures	121,877	121,877	(121,877)	-	-	-
Restricted shares withheld for taxes and related tax benefit	(54,963)	(54,963)	(2,056,229)	-	-	(2,111,192)
Compensation expense for restricted shares	-	-	1,653,662	-	-	1,653,662
Net income	-	-	-	21,842,711	-	21,842,711
Other comprehensive income	-	-	-	-	1,386,878	1,386,878
Balance at March 31, 2015	35,864,667	$35,864,667	$563,831,066	$218,909,667	$5,545,246	$824,150,646
Balance at December 31, 2015	40,906,064	$40,906,064	$839,617,050	$278,573,408	$(3,485,222)	$1,155,611,300
Exercise of employee common stock options and related tax benefits	152,949	152,949	3,699,161	-	-	3,852,110
Common dividends paid	-	-	-	(5,791,835)		(5,791,835)
Issuance of restricted common shares, net of forfeitures	127,462	127,462	(127,462)	-	-	-
Common stock issued in conjunction with Bankers Healthcare Group investment, net of issuance costs	860,470	860,470	38,939,530	-	-	39,800,000
Restricted shares withheld for taxes and related tax benefit	(51,990)	(51,990)	(741,561)	-	-	(793,551)
Compensation expense for restricted shares	-	-	2,628,788	-	-	2,628,788
Net income	-	-	-	27,965,264	-	27,965,264
Other comprehensive income	-	-	-	-	5,507,765	5,507,765
Balance at March 31, 2016	41,994,955	$41,994,955	$884,015,506	$300,746,837	$2,022,543	$1,228,779,841

See accompanying notes to consolidated financial statements (unaudited).

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31, 2016	2015
Operating activities:		
Net income	$27,965,264	$21,842,711
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization/accretion of premium/discount on securities	1,303,239	1,152,427
Depreciation, amortization, and accretion	(428,254)	2,165,601
Provision for loan losses	3,893,570	315,091
Gain on mortgage loans sold, net	(3,567,551)	(1,941,254)
Gain on sale of investment securities	-	(6,003)
Stock-based compensation expense	2,628,788	1,653,662
Deferred tax expense	921,718	1,046,983
Gains on dispositions of other real estate and other investments	(32,400)	(389,731)
Gains from equity method investment	(5,147,524)	(3,201,302)
Excess tax benefit from stock compensation	(159,168)	(1,348,751)
Changes in other loans held for sale	(10,504,481)	-
Mortgage loans held for sale:		
Loans originated	(147,888,687)	(98,711,742)
Loans sold	163,949,000	95,782,000
Increase in other assets	(6,736,913)	(7,631,523)
Decrease in other liabilities	(2,169,127)	(5,480,950)
Net cash provided by operating activities	24,027,474	5,247,219
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(102,041,878)	(64,826,118)
Sales	-	216,300
Maturities, prepayments and calls	28,996,005	29,890,467
Activities in securities held-to-maturity:		
Purchases	-	(1,035,995)
Maturities, prepayments and calls	148,426	235,000
Increase in loans, net	(289,043,266)	(65,558,107)
Purchases of software, premises and equipment	(2,849,721)	(1,222,077)
Increase in equity-method investment	(74,100,000)	(75,000,000)
Dividends received from equity-method investment	4,920,103	-
Increase in other investments	(1,918,978)	(122,500)
Net cash used in investing activities	(435,889,309)	(177,423,030)
Financing activities:		
Net increase in deposits	109,015,688	6,704,511
Net decrease in securities sold under agreements to repurchase	(16,282,804)	(25,941,606)
Advances from Federal Home Loan Bank:		
Issuances	631,000,000	455,370,280
Payments/maturities	(315,015,246)	(195,385,928)

Increase in other borrowings	67,344,645	39,375,000
Exercise of common stock options and stock appreciation rights, net of repurchase of restricted shares	3,058,559	878,138
Excess tax benefit from stock compensation	159,168	1,348,751
Common stock dividends paid	(5,791,835)	(4,304,125)
Net cash provided by financing activities	473,488,175	278,045,021
Net decrease in cash and cash equivalents	61,626,340	105,869,210
Cash and cash equivalents, beginning of period	320,951,333	187,907,510
Cash and cash equivalents, end of period	$382,577,673	$293,776,720

See accompanying notes to consolidated financial statements (unaudited).

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Nature of Business — Pinnacle Financial Partners, Inc. (Pinnacle Financial) is a bank holding company whose primary business is conducted by its wholly-owned subsidiary, Pinnacle Bank. Pinnacle Bank is a commercial bank headquartered in Nashville, Tennessee. Pinnacle Financial completed its acquisitions of CapitalMark Bank & Trust (CapitalMark) and Magna Bank (Magna) (jointly, the acquisitions) on July 31, 2015 and September 1, 2015, respectively. Pinnacle Bank provides a full range of banking services, including investment, mortgage, insurance services, and comprehensive wealth management services, in its primary market areas of the Nashville-Davidson-Murfreesboro-Franklin, Tennessee, Knoxville, Tennessee, Chattanooga, Tennessee-Georgia and Memphis, Tennessee-Mississippi-Arkansas Metropolitan Statistical Areas.

Basis of Presentation — The accompanying unaudited consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (U.S. GAAP). All adjustments consisting of normally recurring accruals that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods covered by the report have been included. The accompanying unaudited consolidated financial statements should be read in conjunction with the Pinnacle Financial consolidated financial statements and related notes appearing in the 2015 Annual Report previously filed on Form 10-K.

These consolidated financial statements include the accounts of Pinnacle Financial and its wholly-owned subsidiaries. PNFP Statutory Trust I, PNFP Statutory Trust II, PNFP Statutory Trust III and PNFP Statutory Trust IV are affiliates of Pinnacle Financial and are included in these consolidated financial statements pursuant to the equity method of accounting. Significant intercompany transactions and accounts are eliminated in consolidation.

Use of Estimates — The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses, determination of impairment of intangible assets, including goodwill, the valuation of deferred tax assets, and our investment portfolio, including other-than-temporary impairment. These financial statements should be read in conjunction with Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2015. There have been no significant changes to Pinnacle Financial's significant accounting policies as disclosed in Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2015.

Cash Flow Information — Supplemental cash flow information addressing certain cash and noncash transactions for each of the three months ended March 31, 2016 and March 31, 2015 was as follows:

	For the three months ended	
	March 31, 2016	March 31, 2015
Cash Transactions:		
Interest paid	$7,341,784	$3,426,798
Income taxes paid, net	10,556,737	8,217,500

Noncash Transactions:		
Loans charged-off to the allowance for loan losses	9,226,906	2,649,708
Loans foreclosed upon and transferred to other real estate owned	-	-
Loans foreclosed upon and transferred to other assets	1,384,511	1,738,757

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Income Per Common Share — Basic net income per common share (EPS) is computed by dividing net income by the weighted average common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted. The difference between basic and diluted weighted average shares outstanding is attributable to common stock options, common stock appreciation rights, restricted share awards, and restricted share unit awards. The dilutive effect of outstanding options, common stock appreciation rights, restricted share awards, and restricted share unit awards is reflected in diluted EPS by application of the treasury stock method. Approximately 552,327 restricted share units are not included in the weighted-average shares outstanding as they are deemed to be contingently issuable.

The following is a summary of the basic and diluted net income per share calculations for the three months ended March 31, 2016 and 2015:

	Three months ended March 31,	
	2016	2015
Basic net income per share calculation:		
Numerator - Net income	$27,965,264	$21,842,711
Denominator - Average common shares outstanding	40,082,805	35,041,203
Basic net income per share	$0.70	$0.62
Diluted net income per share calculation:		
Numerator – Net income	$27,965,264	$21,842,711
Denominator - Average common shares outstanding	40,082,805	35,041,203
Dilutive shares contingently issuable	764,222	339,326
Average diluted common shares outstanding	40,847,027	35,380,529
Diluted net income per share	$0.68	$0.62

Mortgage Servicing Rights — In conjunction with the acquisition of Magna, Pinnacle Bank acquired a residential mortgage servicing portfolio which was recorded at fair value upon acquisition. The residential mortgage servicing portfolio was recorded at $6.4 million as of December 31, 2015, net of related amortization. During the first quarter of 2016, Pinnacle Bank sold the mortgage servicing rights associated with the $830 million Fannie Mae portfolio for $6.8 million, net of associated costs to sell. The purchase agreement related to the sale of these rights includes certain clawback provisions which require Pinnacle Bank to reimburse the acquirer in the event certain conditions are met. Approximately $241,000 was recorded as income in the first quarter of 2016, with the remainder established as a reserve for any potential repurchase obligations.

Proposed merger with Avenue Financial Holdings, Inc. (Avenue) — On January 28, 2016, Pinnacle Financial entered into an Agreement and Plan of Merger (the Merger Agreement) by and between Pinnacle Financial and Avenue, a publicly traded bank holding company, pursuant to which Avenue will merge with and into Pinnacle Financial, with Pinnacle Financial continuing as the surviving corporation (the Avenue Merger). The separate existence of Avenue will cease to exist upon the effectiveness of the Avenue Merger. In connection with the execution of the Merger Agreement, Pinnacle Bank and Avenue Bank, Avenue's wholly owned bank subsidiary, also entered into an Agreement and Plan of Merger pursuant to which Avenue Bank will merge with and into Pinnacle Bank simultaneously with the consummation of the Avenue Merger.

Pursuant to the terms of the Merger Agreement, upon consummation of the Avenue Merger each holder of Avenue common stock issued and outstanding, subject to certain exceptions, will be eligible to receive 0.36 shares of Pinnacle Financial's common stock and an amount in cash equal to $2.00 for each share of Avenue common stock owned by them at the effective time of the Avenue Merger. As of the date of the Merger Agreement, Avenue had 10,322,055 shares of common stock issued and outstanding (including shares of restricted stock) and 257,639 outstanding stock options, all of which are, or will be, fully vested and exercisable prior to the closing of the Avenue Merger.

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Cash will be paid in lieu of any fractional shares of Pinnacle Financial common stock that would otherwise be issued in the Avenue Merger based on the average closing price of Pinnacle Financial's common stock for the ten (10) trading days ending on the business day immediately preceding the closing date of the Avenue Merger. Additionally, any outstanding options to purchase shares of common stock of Avenue that are not vested will be accelerated prior to, but conditioned on the occurrence of, the closing of the Avenue Merger and all options that are not exercised prior to the closing shall be cancelled and the holders of any such options shall receive an amount in cash equal to the product of (x) the excess, if any, of $20.00 over the exercise price of each such option and (y) the number of shares of Avenue common stock subject to each such option.

Pinnacle Financial has filed a registration statement on Form S-4 with the Securities and Exchange Commission (the SEC) with respect to the issuance of its common stock in connection with the Avenue Merger.

The proposed Avenue Merger is subject to the satisfaction of customary closing conditions, including obtaining approvals from applicable federal and state banking regulators and Avenue's shareholders. Additionally, the Merger Agreement contains certain termination rights that may require Avenue to pay Pinnacle Financial a termination fee of $8,000,000 under certain specified circumstances, including if Avenue terminates the Merger Agreement to enter into a definitive agreement for a transaction that its board of directors has determined is superior to the Avenue Merger.

In addition, upon consummation of the Avenue Merger, Pinnacle Financial will assume Avenue's obligations under its outstanding $20.0 million subordinated notes issued in December 2014 that mature in December 2024. These notes bear interest at a rate of 6.75% per annum until January 1, 2020 and may not be repaid prior to such date. Beginning on January 1, 2020, if not redeemed on such date, these notes will bear interest at a floating rate equal to the three-month LIBOR determined on the determination date of the applicable interest period plus 4.95%.

Recently Adopted Accounting Pronouncements — In April 2015, the Financial Accounting Standards Board (FASB) issued ASU 2015-03 Simplifying the Presentation of Debt Issuance Costs requiring that debt issuance costs related to a debt liability be presented in the balance sheet as a direct reduction from the carrying amount of that debt liability. The guidance became effective on January 1, 2016. As a result of the adoption of this standard, Pinnacle Financial reclassified approximately $870,000 of deferred financing costs from Other Assets to Subordinated Debt and Other Borrowings in the consolidated balance sheet as of December 31, 2015.

Note 2. Acquisitions

Investment - Bankers Healthcare Group, LLC. On February 1, 2015, Pinnacle Bank acquired a 30% interest in Bankers Healthcare Group (BHG) for $75 million in cash. On March 1, 2016, Pinnacle Bank and Pinnacle Financial increased their investment in BHG by 19% for a total investment in BHG of 49%. The additional 19% interest was acquired pursuant to a Membership Interest Purchase Agreement dated March 1, 2016 (Purchase Agreement). Pinnacle Financial and Pinnacle Bank acquired, pursuant to the Purchase Agreement, an additional 8.55% and 10.45%, respectively, of the outstanding membership interests in BHG in exchange for an amount of cash equal to $74.1 million (with $11.4 million paid by Pinnacle Financial and $62.7 million paid by Pinnacle Bank) and 860,470 shares of Pinnacle Financial common stock.

The 860,470 shares of Pinnacle Financial common stock issued at the closing of the investment were issued in a private placement exempt from registration under Section 4(2) of the Securities Act of 1933, as amended (the Securities Act), and Rule 506 of Regulation D promulgated under the Securities Act. Subsequent to the issuance of the 860,470 shares, Pinnacle Financial filed with the SEC, a registration statement on Form S-3 covering the resale of such shares as a secondary offering to be made on a continuous basis pursuant to Rule 415 of the Securities Act.

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At the closing of the investment, Pinnacle Financial, Pinnacle Bank and the other members of BHG entered into an Amended and Restated Limited Liability Company Agreement of BHG that provides for, among other things, the following terms: (i) the inability of any member of BHG to transfer its ownership interest in BHG without the consent of the other members of BHG for five years, other than transfers to family members, trusts or affiliates of the transferring member, in connection with the acquisition of Pinnacle Financial or Pinnacle Bank or as a result of a change in applicable law that forces Pinnacle Financial and/or Pinnacle Bank to divest their ownership interests in BHG; (ii) the inability of the board of management of BHG (of which Pinnacle Financial and Pinnacle Bank shall have the right to designate two of the five members (the Pinnacle Managers) to approve a sale of BHG without the consent of one of the Pinnacle Managers for four years; (iii) co-sale rights for Pinnacle Financial and Pinnacle Bank in the event the other members of BHG decide to sell all or a portion of their ownership interests after the above-described five-year limitation; and (iv) a right of first refusal for BHG and the other members of BHG in the event that Pinnacle Financial and/or Pinnacle Bank decide to sell all or a portion of their ownership interests after the above-described five-year limitation, except in connection with a transfer of their ownership interests to an affiliate or in connection with the acquisition of Pinnacle Financial or Pinnacle Bank.

Pinnacle Bank accounts for this investment pursuant to the equity method for unconsolidated subsidiaries and will recognize its interest in BHG's profits and losses in noninterest income with corresponding adjustments to the BHG investment account. Additionally, Pinnacle Bank will not recognize any goodwill or other intangible asset associated with the transaction, however, it will recognize amortization expense associated with certain amounts related to BHG's customer list and data processing capabilities, which are components of the equity method investment.

Acquisition - CapitalMark Bank & Trust. On July 31, 2015, Pinnacle Financial consummated its merger with CapitalMark Bank & Trust (CapitalMark). Pursuant to the terms of the Agreement and Plan of Merger dated as of April 7, 2015 by and among Pinnacle Financial, Pinnacle Bank, and CapitalMark (the CapitalMark Merger Agreement), CapitalMark merged with and into Pinnacle Bank, with Pinnacle Bank continuing as the surviving corporation (the CapitalMark Merger).
The following summarizes consideration paid and a preliminary allocation of purchase price to net assets acquired (dollars in thousands):

	Number of Shares	Amount
Equity consideration:		
Common stock issued	3,306,184	$175,525
Fair value of stock options assumed		30,430
Total equity consideration		$205,955
Non-equity consideration - Cash		19,675
Total consideration paid		$225,630
Allocation of total consideration paid:		
Fair value of net assets assumed including estimated identifiable intangible assets		$67,432
Goodwill		158,198
		$225,630

Acquisition of Magna Bank. On September 1, 2015, Pinnacle Financial consummated its previously announced acquisition of Magna Bank ("Magna"). Pursuant to the terms of the Agreement and Plan of Merger dated as of April 28, 2015 by and among Pinnacle Financial, Pinnacle Bank and Magna (the Magna Merger Agreement), Magna merged with and into Pinnacle Bank, with Pinnacle Bank continuing as the surviving corporation (the Magna Merger).

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The following summarizes consideration paid and a premilinary allocation of purchase price to net assets acquired (dollars in thousands):

	Number of Shares	Amount
Equity consideration:		
Common stock issued	1,371,717	$63,538
Total equity consideration		$63,538
Non-equity consideration		
Cash paid to redeem common stock		$19,453
Cash paid to exchange outstanding stock options		847
Total consideration paid		$83,838
Allocation of total consideration paid:		
Fair value of net assets assumed including estimated identifiable intangible assets		$52,371
Goodwill		31,467
		$83,838

Pinnacle Financial accounted for the aforementioned completed mergers under the acquisition method in accordance with ASC Topic 805. Accordingly, the purchase price is allocated to the fair value of the assets acquired and liabilities assumed as of the date of merger. The following purchase price allocations on the completed mergers are preliminary and will be finalized upon the receipt of final valuations on certain assets and liabilities. Upon receipt of final fair value estimates, which must be within one year of the merger dates, Pinnacle Financial will make any final adjustments to the purchase price allocation and prospectively adjust any goodwill recorded. Material adjustments to merger date estimated fair values would be recorded in the period in which the merger occurred, and as a result, previously reported results are subject to change. Information regarding Pinnacle Financial's loan discount and related deferred tax asset, core deposit intangible asset and related deferred tax liability, as well as income taxes payable and the related deferred tax balances recorded in the mergers, may be adjusted as Pinnacle Financial refines its estimates. Determining the fair value of assets and liabilities, particularly illiquid assets and liabilities, is a complicated process involving significant judgment regarding estimates and assumptions used to calculate estimated fair value. Fair value adjustments based on updated estimates could materially affect the goodwill recorded on the merger. Pinnacle Financial may incur losses on the acquired loans that are materially different from losses Pinnacle Financial originally projected.

The acquired assets and liabilities, as well as the preliminary adjustments to record the assets and liabilities at their estimated fair values, are presented in the following tables (in thousands):

CapitalMark

	As of July 31, 2015		
	CapitalMark Historical Cost Basis	Preliminary Fair Value Adjustments	As Recorded by Pinnacle Financial
Assets			
Cash and cash equivalents	$28,021	$ -	$28,021
Investment securities[1]	150,799	(399)	150,400
Loans[2]	880,115	(22,600)[6]	857,515
Mortgage loans held for sale	1,791	-	1,791
Other real estate owned	1,728	-	1,728

Core deposit intangible(3)	-	6,193	6,193
Other assets(6)(7)	37,252	6,566	43,818
Total Assets	$1,099,706	$ (10,240)	$1,089,466
Liabilities			
Interest-bearing deposits(4)	$758,492	$ 891	$759,383
Non-interest bearing deposits	193,798	-	193,798
Borrowings(5)	32,874	228	33,102
Other liabilities	35,751	-	35,751
Total Liabilities	$1,020,915	$ 1,119	$1,022,034
Net Assets Acquired	$78,791	$ (11,359)	$67,432

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Explanation of certain fair value adjustments:

(1) The amount represents the adjustment of the book value of CapitalMark's investment securities to their estimated fair value on the date of acquisition.

(2) The amount represents the adjustment of the net book value of CapitalMark's loans to their estimated fair value based on current interest rates and expected cash flows, which includes estimates of expected credit losses inherent in the portfolio.

(3) The amount represents the fair value of the core deposit intangible asset representing the intangible value of the deposit base created in the acquisition.

(4) The adjustment is necessary because the weighted average interest rate of CapitalMark's deposits exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(5) The adjustment is necessary because the weighted average interest rate of CapitalMark's FHLB advances exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(6) During 2016, an additional adjustment of $400,000 to goodwill was made to reduce the value of an acquired investment to zero after determining the investment was worthless. Further a reduction in the loan fair value adjustment was recorded upon the receipt of the final loan mark valuation in the amount of $206,000.

(7) The amount represents the deferred tax asset recognized on the fair value adjustment of CapitalMark's acquired assets and assumed liabilities as well as the fair value adjustment on premises and equipment.

<u>Magna</u>

	As of September 1, 2015		
	Magna Historical Cost Basis	Preliminary Fair Value Adjustments	As Recorded by Pinnacle Financial
Assets			
Cash and cash equivalents	$17,832	$ -	$17,832
Investment securities[1]	60,018	(280)	59,738
Loans[2]	453,108	(10,760)[8]	442,348
Mortgage loans held for sale	18,886	-	18,886
Other real estate owned[3]	1,471	139	1,610
Core deposit intangible[4]	-	3,170	3,170
Other assets[5]	32,974	4,216	37,190
Total Assets	$584,289	$ (3,515)	$580,774
Liabilities			
Interest-bearing deposits[6]	$402,535	$ 1,268	$403,803
Non-interest bearing deposits	48,851	-	48,851
Borrowings[7]	46,900	506	47,406
Other liabilities	28,343	-	28,343
Total Liabilities	$526,629	$ 1,774	$528,403
Net Assets Acquired	$57,660	$ (5,289)	$52,371

Explanation of certain fair value adjustments:

(1) The amount represents the adjustment of the book value of Magna's investment securities to their estimated fair value on the date of acquisition.

(2) The amount represents the adjustment of the net book value of Magna's loans to their estimated fair value based on current interest rates and expected cash flows, which includes estimates of expected credit losses inherent in the portfolio.

(3) The amount represents the adjustment to the book value of Magna's OREO to fair value on the date of acquisition.

(4) The amount represents the fair value of the core deposit intangible asset representing the intangible value of the deposit base created in the acquisition.

(5) The amount represents the deferred tax asset recognized on the fair value adjustment of Magna's acquired assets and assumed liabilities as well as the fair value adjustment for the mortgage servicing right and property and equipment.

(6) The adjustment is necessary because the weighted average interest rate of Magna's deposits exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(7) The adjustment is necessary because the weighted average interest rate of Magna's FHLB advances exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(8) A reduction in the loan fair value adjustment was recorded upon receipt of the final loan mark valuation in the amount of $426,000.

Note 3. Equity method investment

Upon its initial investment in BHG, Pinnacle Bank accounted for this investment pursuant to the equity method for unconsolidated subsidiaries and recognized its interest in BHG's profits and losses in noninterest income with corresponding adjustments to the BHG investment account. Because BHG has been determined to be a voting interest entity of which Pinnacle Financial and Pinnacle Bank control less than a majority of the board seats following the closing of the additional investment in March 2016, this investment does not require consolidation and will continue to be accounted for pursuant to the equity method of accounting.

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The equity method of accounting requires that embedded goodwill and intangibles should be identified, tested for impairment and amortized over their useful life within the equity method investment line of the balance sheet. Amortization expense associated with BHG's customer list and data processing capabilities is netted within income from equity method investments. At March 31, 2016, Pinnacle Financial has recorded estimated embedded goodwill of $139.1 million and $16.0 million, net of related amortization, for technology, trade name and customer relationship intangibles compared to $50.6 million and $5.1 million, respectively, as of December 31, 2015. Pinnacle has not yet completed the purchase accounting for the subsequent investment in BHG and the estimates of equity embedded goodwill and intangible assets are considered preliminary as of March 31, 2016. During the first quarter of 2016, Pinnacle Financial recorded earnings of $5.5 million, net of approximately $370,000 in intangible amortization expense compared to recorded earnings of $3.6 million, net of approximately $400,000 in intangible amortization expense for the three months ended March 31, 2015. Earnings from BHG are included in Pinnacle Financial's consolidated tax return. Profit from intercompany transactions are eliminated as a part of consolidation. As part of ongoing business transacted with BHG, Pinnacle Bank purchased loans from BHG totaling $2.2 million during the year ended December 31, 2015. No loans were purchased for the period ended March 31, 2016.

A summary of BHG's financial position as of March 31, 2016 and December 31, 2015 and results of operations for the three months ended March 31, 2016 and 2015, were as follows (in thousands):

Banker's Healthcare Group
($ in thousands)

	As of March 31, 2016	December 31, 2015
Assets	$208,244	220,578
Liabilities	141,445	137,147
Membership interests	66,799	83,431
Total liabilities and membership	$208,244	220,578

	For the three months ended March 31, 2016	March 31, 2015
Revenues	$31,288	27,045
Net income, pre-tax	$12,154	14,384

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Note 4. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at March 31, 2016 and December 31, 2015 are summarized as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2016				
Securities available-for-sale:				
U.S. Treasury securities	$-	$ -	$ -	$-
U.S. government agency securities	130,459	75	1,067	129,467
Mortgage-backed agency securities	657,409	9,693	1,393	665,709
State and municipal securities	157,422	8,358	35	165,745
Asset-backed securities	48,225	-	1,212	47,013
Corporate notes and other	8,733	683	20	9,396
	$1,002,248	$ 18,809	$ 3,727	$1,017,330
Securities held-to-maturity:				
State and municipal securities	$31,089	$ 435	$ 3	$31,521
	$31,089	$ 435	$ 3	$31,521
December 31, 2015:				
Securities available-for-sale:				
U.S. Treasury securities	$-	$ -	$ -	$-
U.S. government agency securities	131,499	3	3,309	128,193
Mortgage-backed agency securities	581,998	5,948	5,030	582,916
State and municipal securities	158,072	7,094	124	165,042
Asset-backed securities	49,598	8	805	48,801
Corporate notes and other	9,541	589	17	10,113
	$930,708	$ 13,642	9,285	$935,065
Securities held-to-maturity:				
State and municipal securities	$31,377	$ 257	$ 48	$31,586
	$31,377	$ 257	$ 48	$31,586

At March 31, 2016, approximately $828.5 million of securities within Pinnacle Financial's investment portfolio were either pledged to secure public funds and other deposits or securities sold under agreements to repurchase. At March 31, 2016 repurchase agreements comprised of secured borrowings totaled $62.8 million and were secured by $62.8 million of pledged U.S. government agency securities, municipal securities, asset backed securities, and corporate debentures. The fair value of securities pledged to secure repurchase agreements may decline. As the fair value of securities pledged to secure repurchase agreements may decline, the company regularly evaluates its need to pledge additional securities to remain adequately secured.

The amortized cost and fair value of debt securities as of March 31, 2016 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage- and asset-backed securities since the mortgages and assets underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary (in thousands):

	Available-for-sale		Held-to-maturity	
March 31, 2016:	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$5,392	$5,418	$1,212	$1,214
Due in one year to five years	33,915	36,365	8,629	8,704
Due in five years to ten years	191,294	196,034	12,745	13,014
Due after ten years	66,013	66,791	8,503	8,589
Mortgage-backed securities	657,409	665,709	-	-
Asset-backed securities	48,225	47,013	-	-
	$1,002,248	$1,017,330	$31,089	$31,521

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At March 31, 2016 and December 31, 2015, the following investments had unrealized losses. The table below classifies these investments according to the term of the unrealized losses of less than twelve months or twelve months or longer (in thousands):

	Investments with an Unrealized Loss of less than 12 months		Investments with an Unrealized Loss of 12 months or longer		Total Investments with an Unrealized Loss	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At March 31, 2016						
U.S. Treasury securities	$-	$ -	$-	$ -	$-	$ -
U.S. government agency securities	16,755	712	41,188	355	57,943	1,067
Mortgage-backed securities	122,091	549	69,670	844	191,761	1,393
State and municipal securities	899	12	4,404	26	5,303	38
Asset-backed securities	32,802	917	14,210	295	47,012	1,212
Corporate notes	1,232	20	-	-	1,232	20
Total temporarily-impaired securities	$173,779	$ 2,210	$129,472	$ 1,520	$303,251	$ 3,730
At December 31, 2015						
U.S. Treasury securities	$-	$ -	$-	$ -	$-	$ -
U.S. government agency securities	61,903	1,702	65,538	1,607	127,441	3,309
Mortgage-backed securities	338,230	2,789	103,003	2,241	441,233	5,030
State and municipal securities	6,509	38	6,135	134	12,644	172
Asset-backed securities	41,466	798	3,539	7	45,005	805
Corporate notes	2,554	17	-	-	2,554	17
Total temporarily-impaired securities	$450,662	$ 5,344	$178,215	$ 3,989	$628,877	$ 9,333

The applicable dates for determining when securities are in an unrealized loss position are March 31, 2016 and December 31, 2015. As such, it is possible that a security had a market value that exceeded its amortized cost on other days during the past twelve-month periods ended March 31, 2016 and December 31, 2015, but is in the "Investments with an Unrealized Loss of less than 12 months" category above.

As shown in the tables above, at March 31, 2016, Pinnacle Financial had approximately $3.7 million in unrealized losses on $303.3 million of securities. The unrealized losses associated with these investment securities are driven by changes in interest rates and the unrealized loss is recorded as a component of equity. These securities will continue to be monitored as a part of our ongoing impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond issuers. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. If a shortfall in future cash flows is identified, a credit loss will be deemed to have occurred and will be recognized as a charge to earnings and a new cost basis for the security will be established.

Because Pinnacle Financial currently does not intend to sell those securities that have an unrealized loss at March 31, 2016, and it is not more-likely-than-not that Pinnacle Financial will be required to sell the securities before recovery of their amortized cost bases, which may be maturity, Pinnacle Financial does not consider these securities to be other-than-temporarily impaired at March 31, 2016.

Periodically, available-for-sale securities may be sold or the composition of the portfolio realigned to improve yields, quality or marketability, or to implement changes in investment or asset/liability strategy, including maintaining collateral requirements and raising funds for liquidity purposes. Additionally, if an available-for-sale security loses its investment grade or tax-exempt status, the underlying credit support is terminated or collection otherwise becomes uncertain based on factors known to management, Pinnacle Financial will consider selling the security, but will review each security on a case-by-case basis as these factors become known.

The carrying values of Pinnacle Financial's investment securities could decline in the future if the financial condition of issuers deteriorates and management determines it is probable that Pinnacle Financial will not recover the entire amortized cost bases of the securities. As a result, there is a risk that other-than-temporary impairment charges may occur in the future. Additionally, there is a risk that other-than-temporary impairment charges may occur in the future if management's intention to hold these securities to maturity and or recovery changes.

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Note 5. Loans and Allowance for Loan Losses

For financial reporting purposes, Pinnacle Financial classifies its loan portfolio based on the underlying collateral utilized to secure each loan. This classification is consistent with those utilized in the Quarterly Report of Condition and Income filed with the Federal Deposit Insurance Corporation (FDIC).

Pinnacle Financial uses five loan categories: commercial real estate mortgage, consumer real estate mortgage, construction and land development, commercial and industrial, and consumer and other.

- Commercial real-estate mortgage loans. Commercial real-estate mortgage loans are categorized as such based on investor exposures where repayment is largely dependent upon the operation, refinance, or sale of the underlying real estate. Commercial real-estate mortgage also includes owner occupied commercial real estate which shares a similar risk profile to our commercial and industrial products.
- Consumer real-estate mortgage loans. Consumer real-estate mortgage consists primarily of loans secured by 1-4 residential properties including home equity lines of credit.
- Construction and land development loans. Construction and land development loans include loans where the repayment is dependent on the successful operation of the related real estate project. Construction and land development loans include 1-4 family construction projects and commercial construction endeavors such as warehouses, apartments, office and retail space and land acquisition and development.
- Commercial and industrial loans. Commercial and industrial loans include loans to business enterprises issued for commercial, industrial and/or other professional purposes.
- Consumer and other loans. Consumer and other loans include all loans issued to individuals not included in the consumer real-estate mortgage classification. Examples of consumer and other loans are automobile loans, credit cards and loans to finance education, among others.

Commercial loans receive risk ratings assigned by a financial advisor and approved by a senior credit officer subject to validation by Pinnacle Financial's independent loan review department. Risk ratings are categorized as pass, special mention, substandard, substandard-nonaccrual or doubtful-nonaccrual. Pinnacle Financial believes that its categories follow those used by Pinnacle Bank's primary regulators. At March 31, 2016, approximately 74.55% of our loan portfolio was analyzed as a commercial loan type with a specifically assigned risk rating in the allowance for loan loss assessment. Consumer loans and small business loans are generally not assigned an individual risk rating but are evaluated as either accrual or nonaccrual based on the performance of the individual loans. However, certain consumer real-estate mortgage loans and certain consumer and other loans receive a specific risk rating due to the loan proceeds being used for commercial purposes even though the collateral may be of a consumer loan nature.

Risk ratings are subject to continual review by a financial advisor and a senior credit officer. At least annually, our credit procedures require that every risk rated loan of $500,000 or more be subject to a formal credit risk review process by the assigned financial advisor. Each loan's risk rating is also subject to review by our independent loan review department, which reviews a substantial portion of our risk rated portfolio annually. Included in the coverage are independent loan reviews of loans in targeted higher-risk portfolio segments such as certain commercial and industrial loans, land loans and/or loan types in certain geographies.

The following table presents our loan balances by primary loan classification and the amount within each risk rating category. Pass rated loans include all credits other than those included in special mention, substandard, substandard-nonaccrual and doubtful-nonaccrual which are defined as follows:

Special mention loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in Pinnacle Financial's credit position at some future date.

Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize collection of the debt. Substandard loans are characterized by the distinct possibility that Pinnacle Financial will sustain some loss if the deficiencies are not corrected.

Substandard-nonaccrual loans are substandard loans that have been placed on nonaccrual status.

Doubtful-nonaccrual loans have all the characteristics of substandard-nonaccrual loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

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The following table outlines the amount of each loan classification categorized into each risk rating category as of March 31, 2016 and December 31, 2015 (in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Total
March 31, 2016						
Accruing loans						
Pass	$2,285,128	$1,013,661	$ 746,663	$2,314,663	$242,170	$6,602,285
Special Mention	15,494	2,789	2,537	39,791	106	60,717
Substandard [1]	34,518	12,250	7,686	57,939	61	112,454
Total	2,335,140	1,028,700	756,886	2,412,393	242,337	6,775,456
Impaired loans						
Nonaccrual loans[2]						
Substandard-nonaccrual	5,356	10,178	7,193	15,959	3,742	42,428
Doubtful-nonaccrual	2	2	-	92	-	96
Total nonaccrual loans	5,358	10,180	7,193	16,051	3,742	42,524
Troubled debt restructurings[3]						
Pass	222	404	-	292	27	945
Special Mention	-	247	-	-	-	247
Substandard	-	2,838	-	5,920	-	8,758
Total troubled debt restructurings	222	3,489	-	6,212	27	9,950
Total impaired loans	5,580	13,669	7,193	22,263	3,769	52,474
Total loans	$2,340,720	$1,042,369	$ 764,079	$2,434,656	$246,106	$6,827,930
December 31, 2015						
Accruing loans						
Pass	$2,217,639	$1,020,239	$732,662	$2,143,006	$239,874	$6,353,420
Special Mention	18,162	1,894	1,133	26,037	118	47,344
Substandard [1]	33,638	11,346	6,295	53,671	74	105,024
Total	2,269,439	1,033,479	740,090	2,222,714	240,066	6,505,788
Impaired loans						
Nonaccrual loans[2]						
Substandard-nonaccrual	5,819	9,344	7,607	1,591	4,902	29,263
Doubtful-nonaccrual	2	2	-	92	-	96
Total nonaccrual loans	5,821	9,346	7,607	1,683	4,902	29,359
Troubled debt restructurings[3]						
Pass	223	409	-	553	28	1,213
Special Mention	-	422	-	-	-	422
Substandard	-	2,861	-	3,592	-	6,453
Total troubled debt restructurings	223	3,692	-	4,145	28	8,088
Total impaired loans	6,044	13,038	7,607	5,828	4,930	37,447
Total loans	$2,275,483	$1,046,517	$747,697	$2,228,542	$244,996	$6,543,235

(1) Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by

Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of nonaccrual loans and troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately $112.5 million at March 31, 2016, compared to $105.0 million at December 31, 2015.

(2) Included in nonaccrual loans at March 31, 2016 and December 31, 2015 are $10.8 million and $12.1 million, respectively, in purchase credit impaired loans acquired with deteriorated credit quality.

(3) Troubled debt restructurings are presented as an impaired loan; however, they continue to accrue interest at contractual rates.

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At March 31, 2016 and December 31, 2015, all loans classified as nonaccrual were deemed to be impaired. The principal balances of these nonaccrual loans amounted to $42.5 million and $29.4 million at March 31, 2016 and December 31, 2015, respectively, and are included in the tables above. For the three months ended March 31, 2016, the average balance of nonaccrual loans was $43.7 million compared to $21.6 million for the year ended December 31, 2015. Pinnacle Financial's policy is that the discontinuation of the accrual of interest income will occur when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well secured and in the process of collection. As such, at the date the above mentioned loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Pinnacle Financial's policy is that once a loan is placed on nonaccrual status each subsequent payment is reviewed on a case-by-case basis to determine if the payment should be applied to interest or principal pursuant to regulatory guidelines. Pinnacle Financial recognized approximately $31,000 in interest income from cash payments received on nonaccrual loans during the three months ended March 31, 2016, and $308,000 in interest income from cash payments received on nonaccrual loans during the year ended December 31, 2015. Had these nonaccruing loans been on accruing status, interest income would have been higher by $280,000 for the three months ended March 31, 2016 and by $333,000 for the three months ended March 31, 2015.

The following table details the recorded investment, unpaid principal balance and related allowance and average recorded investment of our nonaccrual loans at March 31, 2016 and December 31, 2015 by loan classification and the amount of interest income recognized on a cash basis throughout the fiscal year-to-date period then ended, respectively, on these loans that remain on the balance sheets (in thousands):

	At March 31, 2016			For the three months ended March 31, 2016	
	Recorded investment	Unpaid principal balance(1)	Related allowance(2)	Average recorded investment	Interest income recognized
Collateral dependent nonaccrual loans:					
Commercial real estate – mortgage	$3,826	$ 4,491	$ -	$3,854	$ -
Consumer real estate – mortgage	4,431	4,916	-	4,462	-
Construction and land development	7,122	7,526	-	7,320	31