PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
August 05, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(mark one)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
or
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 August 2, 2016 there were 46,140,190 shares of common stock, $1.00 par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
June 30, 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 Bankers Healthcare Group (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; (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 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 Pinnacle Financial's and Pinnacle Bank's recent mergers may not be realized or take longer than anticipated to be realized; (xix) disruption from the Avenue Financial Holdings, Inc. (Avenue) merger with customers, suppliers or employee relationships; (xx) the risk of successful integration of the businesses Pinnacle Financial recently acquired with Pinnacle Financial's; (xxi) the amount of the costs, fees, expenses and charges related to the Avenue merger; (xxii) risk of adverse reaction of Pinnacle Bank's and Avenue's customers to the Avenue merger; (xxiii) the risk that the integration of the operations of the companies Pinnacle Financial recently acquired with Pinnacle Financial's will be materially delayed or will be more costly or difficult than expected; (xxix) approval of the declaration of any dividend by Pinnacle Financial's board of directors; (xxx) 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; (xxxi) the possibility of increased compliance costs or modifications to our business plan or the business plan of entities in which we have made an investment 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; (xxxii) 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; (xxxiii) the possibility that the incremental cost and/or decreased revenues associated with exceeding $10 billion in assets will exceed current estimates; and (xxxiv) changes in state and federal legislation, regulations or policies applicable to banks and other financial service providers (like BHG), 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.
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Item 1. Part I. Financial Information

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

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| ASSETS | | |
| Cash and noninterest-bearing due from banks | $77,817,212 | $75,078,807 |
| Interest-bearing due from banks | 390,839,578 | 219,202,464 |
| Federal funds sold and other | 3,124,302 | 26,670,062 |
| Cash and cash equivalents | 471,781,092 | 320,951,333 |
| | | |
| Securities available-for-sale, at fair value | 1,109,221,784 | 935,064,745 |
| Securities held-to-maturity (fair value of $29,092,450 and $31,585,303 at June 30, 2016 and December 31, 2015, respectively) | 28,511,599 | 31,376,840 |
| Consumer mortgage loans held-for-sale | 53,118,706 | 47,930,253 |
| Commercial mortgage loans held-for-sale | 9,322,783 | - |
| | | |
| Loans | 7,091,401,512 | 6,543,235,381 |
| Less allowance for loan losses | (61,411,537 ) | (65,432,354 ) |
| Loans, net | 7,029,989,975 | 6,477,803,027 |
| | | |
| Premises and equipment, net | 78,800,120 | 77,923,607 |
| Equity method investment | 195,891,508 | 88,880,014 |
| Accrued interest receivable | 23,432,495 | 21,574,096 |
| Goodwill | 427,573,930 | 432,232,255 |
| Core deposits and other intangible assets | 8,820,668 | 10,540,497 |
| Other real estate owned | 5,005,642 | 5,083,218 |
| Other assets | 294,197,558 | 265,183,799 |
| Total assets | $9,735,667,860 | $8,714,543,684 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing | $2,013,847,185 | $1,889,865,113 |
| Interest-bearing | 1,316,653,111 | 1,389,548,175 |
| Savings and money market accounts | 3,237,003,521 | 3,001,950,725 |
| Time | 725,322,534 | 690,049,795 |
| Total deposits | 7,292,826,351 | 6,971,413,808 |
| Securities sold under agreements to repurchase | 73,316,880 | 79,084,298 |
| Federal Home Loan Bank advances | 783,240,425 | 300,305,226 |
| Subordinated debt and other borrowings | 229,713,860 | 141,605,504 |
| Accrued interest payable | 4,067,352 | 2,593,209 |
| Other liabilities | 90,349,182 | 63,930,339 |
| Total liabilities | 8,473,514,050 | 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; 42,184,120 and 40,906,064 shares issued and outstanding | | |

| | | |
|---|---|---|
| at June 30, 2016 and December 31, 2015, respectively | 42,184,120 | 40,906,064 |
| Additional paid-in capital | 889,468,015 | 839,617,050 |
| Retained earnings | 325,608,051 | 278,573,408 |
| Accumulated other comprehensive income (loss), net of taxes | 4,893,624 | (3,485,222 ) |
| Total stockholders' equity | 1,262,153,810 | 1,155,611,300 |
| Total liabilities and stockholders' equity | $9,735,667,860 | $8,714,543,684 |

See accompanying notes to consolidated financial statements (unaudited).

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

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | June 30, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| Interest income: | | | | |
| Loans, including fees | $77,043,106 | $50,325,643 | $151,447,310 | $99,792,349 |
| Securities: | | | | |
| Taxable | 4,571,876 | 3,460,243 | 9,038,710 | 6,904,842 |
| Tax-exempt | 1,443,017 | 1,400,479 | 2,936,774 | 2,883,786 |
| Federal funds sold and other | 703,706 | 316,286 | 1,313,293 | 600,264 |
| Total interest income | 83,761,705 | 55,502,651 | 164,736,087 | 110,181,241 |
| | | | | |
| Interest expense: | | | | |
| Deposits | 5,073,567 | 2,592,476 | 9,989,130 | 5,023,218 |
| Securities sold under agreements to repurchase | 39,532 | 29,371 | 87,582 | 60,288 |
| Federal Home Loan Bank advances and other borrowings | 3,605,320 | 1,050,119 | 5,713,412 | 1,998,671 |
| Total interest expense | 8,718,419 | 3,671,966 | 15,790,124 | 7,082,177 |
| Net interest income | 75,043,286 | 51,830,685 | 148,945,963 | 103,099,064 |
| Provision for loan losses | 5,280,101 | 1,186,116 | 9,173,671 | 1,501,207 |
| Net interest income after provision for loan losses | 69,763,185 | 50,644,569 | 139,772,292 | 101,597,857 |
| | | | | |
| Noninterest income: | | | | |
| Service charges on deposit accounts | 3,430,391 | 3,075,655 | 6,873,075 | 5,988,204 |
| Investment services | 2,499,719 | 2,399,054 | 4,845,319 | 4,658,494 |
| Insurance sales commissions | 1,192,827 | 1,105,783 | 2,898,686 | 2,618,401 |
| Gain on mortgage loans sold, net | 4,221,301 | 1,652,111 | 7,788,852 | 3,593,365 |
| Investment gains on sales, net | - | 556,014 | - | 562,017 |
| Trust fees | 1,491,955 | 1,230,415 | 3,072,567 | 2,542,400 |
| Income from equity method investment | 9,644,310 | 4,266,154 | 14,791,834 | 7,467,456 |
| Other noninterest income | 10,232,433 | 5,733,592 | 18,298,313 | 11,081,743 |
| Total noninterest income | 32,712,936 | 20,018,778 | 58,568,646 | 38,512,080 |
| | | | | |
| Noninterest expense: | | | | |
| Salaries and employee benefits | 34,254,147 | 23,774,558 | 66,771,003 | 47,305,418 |
| Equipment and occupancy | 8,312,272 | 5,877,971 | 16,442,736 | 11,924,194 |
| Other real estate expense (benefit), net | 222,473 | (114,567) | 334,745 | 280,721 |
| Marketing and other business development | 1,537,843 | 1,186,165 | 2,801,204 | 2,145,915 |
| Postage and supplies | 1,049,842 | 731,219 | 2,006,929 | 1,380,470 |
| Amortization of intangibles | 846,615 | 227,413 | 1,719,830 | 454,827 |
| Merger related expense | 980,182 | 59,053 | 2,809,654 | 59,053 |
| Other noninterest expense | 8,727,393 | 5,005,513 | 17,108,362 | 10,027,749 |
| Total noninterest expense | 55,930,767 | 36,747,325 | 109,994,463 | 73,578,347 |
| Income before income taxes | 46,545,354 | 33,916,022 | 88,346,475 | 66,531,590 |
| Income tax expense | 15,758,582 | 11,252,191 | 29,594,439 | 22,025,048 |
| Net income | $30,786,772 | $22,663,831 | $58,752,036 | $44,506,542 |
| Per share information: | | | | |

| | | | | |
|---|---|---|---|---|
| Basic net income per common share | $0.75 | $0.65 | $1.44 | $1.27 |
| Diluted net income per common share | $0.73 | $0.64 | $1.42 | $1.25 |
| Weighted average shares outstanding: | | | | |
| Basic | 41,274,450 | 35,128,856 | 40,678,669 | 35,085,271 |
| Diluted | 41,974,483 | 35,554,683 | 41,411,248 | 35,477,098 |

See accompanying notes to consolidated financial statements (unaudited).

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

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | $30,786,772 | $22,663,831 | $58,752,036 | $44,506,542 |
| Other comprehensive income (loss), net of tax: | | | | |
| Change in fair value on available-for-sale securities, net of tax | 3,211,042 | (4,952,934 ) | 9,642,510 | (3,009,581 ) |
| Change in fair value of cash flow hedges, net of tax | (339,961 ) | (31,598 ) | (1,263,664 ) | (584,425 ) |
| Net gain on sale of investment securities reclassified from other comprehensive income into net income, net of tax | - | (337,890 ) | - | (341,537 ) |
| Total other comprehensive income (loss), net of tax | 2,871,081 | (5,322,422 ) | 8,378,846 | (3,935,543 ) |
| Total comprehensive income | $33,657,853 | $17,341,409 | $67,130,882 | $40,570,999 |

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

| | Common Stock | | Additional Paid-in | Retained | Accumulated Other Comp. | Total Stockholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Earnings | Income, net | Equity |
| 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 | 152,544 | 152,544 | 4,144,437 | - | - | 4,296,981 |
| Common dividends paid | - | - | - | (8,633,757) | - | (8,633,757) |
| Issuance of restricted common shares, net of forfeitures | 150,259 | 150,259 | (150,259) | - | - | - |
| Restricted shares withheld for taxes and related tax benefit | (57,299) | (57,299) | (841,791) | - | - | (899,090) |
| Compensation expense for restricted shares | - | - | 3,361,547 | - | - | 3,361,547 |
| Net income | - | - | - | 44,506,542 | - | 44,506,542 |
| Other comprehensive loss | - | - | - | - | (3,935,543) | (3,935,543) |
| Balance at June 30, 2015 | 35,977,987 | $35,977,987 | $567,945,383 | $237,243,866 | $222,825 | $841,390,061 |
| | | | | | | |
| 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 | 332,094 | 332,094 | 6,798,402 | - | - | 7,130,496 |
| Common dividends paid | - | - | - | (11,717,393) | | (11,717,393) |
| Issuance of restricted common shares, net of forfeitures | 141,331 | 141,331 | (141,331) | - | - | - |
| Common stock issued in conjunction with Bankers Healthcare Group investment, net of issuance costs | 860,470 | 860,470 | 38,827,126 | - | - | 39,687,596 |
| Restricted shares withheld for taxes and related tax benefit | (55,839) | (55,839) | (878,179) | - | - | (934,018) |
| | - | - | 5,244,947 | - | - | 5,244,947 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Compensation expense for restricted shares | | | | | | |
| Net income | - | - | - | 58,752,036 | - | 58,752,036 |
| Other comprehensive income | - | - | - | - | 8,378,846 | 8,378,846 |
| Balance at June 30, 2016 | 42,184,120 | $42,184,120 | $889,468,015 | $325,608,051 | $4,893,624 | $1,262,153,810 |

See accompanying notes to consolidated financial statements (unaudited).

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

| | Six months ended June 30, 2016 | 2015 |
|---|---|---|
| Operating activities: | | |
| Net income | $58,752,036 | $44,506,542 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Net amortization/accretion of premium/discount on securities | 2,940,923 | 2,436,636 |
| Depreciation, amortization, and accretion | 1,220,878 | 4,318,556 |
| Provision for loan losses | 9,173,671 | 1,501,207 |
| Gain on mortgage loans sold, net | (7,788,852) | (3,593,365) |
| Gain on sale of investment securities | - | (562,017) |
| Stock-based compensation expense | 5,244,947 | 3,361,547 |
| Deferred tax expense | 1,750,526 | 613,022 |
| Losses on dispositions of other real estate and other investments | 218,568 | 241,254 |
| Income from equity method investment | (14,791,834) | (7,467,456) |
| Excess tax benefit from stock compensation | (2,422,226) | (1,398,876) |
| Gain on other loans sold, net | (548,560) | - |
| Other loans held for sale: | | |
| Loans originated | (30,854,000) | - |
| Loans sold | 22,079,777 | - |
| Mortgage loans held for sale: | | |
| Loans originated | (195,638,601) | (222,301,417) |
| Loans sold | 198,239,000 | 208,391,000 |
| Decrease (increase) in other assets | (18,585,336) | 5,668,214 |
| Increase (decrease) in other liabilities | 30,286,044 | (6,601,764) |
| Net cash provided by operating activities | 59,276,961 | 29,113,083 |
| | | |
| Investing activities: | | |
| Activities in securities available-for-sale: | | |
| Purchases | (265,495,464) | (180,352,200) |
| Sales | - | 33,290,733 |
| Maturities, prepayments and calls | 104,509,440 | 65,886,600 |
| Activities in securities held-to-maturity: | | |
| Purchases | (560,000) | (1,550,995) |
| Maturities, prepayments and calls | 3,170,000 | 5,935,000 |
| Increase in loans, net | (559,866,109) | (247,698,663) |
| Purchases of software, premises and equipment | (6,700,278) | (6,455,257) |
| Proceeds from sales of software, premises and equipment | 1,949,036 | 654,069 |
| Proceeds from sale of other real estate | 2,323,953 | - |
| Increase in equity method investment | (74,100,000) | (75,425,530) |
| Dividends received from equity method investment | 21,824,256 | - |
| Increase in other investments | (16,944,435) | (720,972) |
| Net cash used in investing activities | (789,889,601) | (406,437,215) |
| | | |
| Financing activities: | | |
| Net increase in deposits | 321,819,132 | 211,006,014 |
| Net decrease in securities sold under agreements to repurchase | (5,767,418) | (32,446,182) |
| Advances from Federal Home Loan Bank: | | |

| | | |
|---|---|---|
| Issuances | 1,528,000,000 | 1,740,000,000 |
| Payments/maturities | (1,045,064,801) | (1,490,108,767) |
| Increase in other borrowings | 87,976,401 | 37,750,000 |
| Exercise of common stock options and stock appreciation rights, net of repurchase of restricted shares | 3,774,252 | 3,397,891 |
| Excess tax benefit from stock compensation | 2,422,226 | 1,398,876 |
| Common stock dividends paid | (11,717,393) | (8,633,757) |
| Net cash provided by financing activities | 881,442,399 | 462,364,075 |
| Net decrease in cash and cash equivalents | 150,829,759 | 85,039,943 |
| Cash and cash equivalents, beginning of period | 320,951,333 | 187,907,510 |
| Cash and cash equivalents, end of period | $471,781,092 | $272,947,453 |

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), Magna Bank (Magna) and Avenue Financial Holdings, Inc. (Avenue) on July 31, 2015, September 1, 2015, and July 1, 2016, respectively. Pinnacle Financial and Pinnacle Bank also collectively hold a 49% interest in Bankers Healthcare Group, LLC (BHG), a full-service commercial loan provider to healthcare and other professional practices. 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 six months ended June 30, 2016 and June 30, 2015 was as follows:

| | For the six months ended | |
|---|---|---|
| | June 30, 2016 | June 30, 2015 |
| Cash Transactions: | | |
| Interest paid | $14,722,572 | $7,099,390 |

| | | |
|---|---|---|
| Income taxes paid, net | 22,364,686 | 17,847,500 |
| Noncash Transactions: | | |
| Loans charged-off to the allowance for loan losses | 16,372,819 | 6,098,606 |
| Loans foreclosed upon and transferred to other real estate owned | 2,464,945 | 252,896 |
| Loans foreclosed upon and transferred to other assets | 1,673,946 | 3,478,159 |

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.

The following is a summary of the basic and diluted net income per share calculations for the three and six months ended June 30, 2016 and 2015:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Basic net income per share calculation: | | | | |
| Numerator - Net income | $30,786,772 | $22,663,831 | $58,752,036 | $44,506,542 |
| Denominator - Average common shares outstanding | 41,274,450 | 35,128,856 | 40,678,669 | 35,085,271 |
| Basic net income per share | $0.75 | $0.65 | $1.44 | $1.27 |
| Diluted net income per share calculation: | | | | |
| Numerator – Net income | $30,786,772 | $22,663,831 | $58,752,036 | $44,506,542 |
| Denominator - Average common shares outstanding | 41,274,450 | 35,128,856 | 40,678,669 | 35,085,271 |
| Dilutive shares [1] | 700,033 | 425,827 | 732,579 | 391,827 |
| Average diluted common shares outstanding | 41,974,483 | 35,554,683 | 41,411,248 | 35,477,098 |
| Diluted net income per share | $0.73 | $0.64 | $1.42 | $1.25 |

(1) Approximately 518,152 restricted share units are not included in the weighted-average shares outstanding as they are deemed to be contingently issuable. Additionally, for the periods ending June 30, 2016 and 2015, there were no share based awards excluded from the diluted earnings per share computation because they were deemed anti-dilutive.

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 in conjunction with a decision to exit the residential servicing line of business, Pinnacle Bank sold the mortgage servicing rights associated with the $830 million Fannie Mae portion of the residential servicing portfolio for $6.6 million, net of associated costs to sell. Approximately $241,000 was recorded as income in the first quarter of 2016 as a result of the sale.

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 the related 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.

Subsequent Events — ASC 855, Subsequent Events, establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. Pinnacle Financial evaluated all events or transactions that occurred after June 30, 2016 through the date of the issued financial statements.

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 would merge with and into Pinnacle Financial, with Pinnacle Financial continuing as the surviving corporation (the Avenue Merger). On July 1, 2016, Avenue merged with Pinnacle Financial. On that same day, Pinnacle Bank and Avenue Bank merged, with Pinnacle Bank continuing as the surviving bank.

Pursuant to the terms of the Merger Agreement, each holder of Avenue common stock issued and outstanding, subject to certain exceptions, received 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.

Cash was 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 were not vested were accelerated prior to, but conditioned on the occurrence of, the closing of the Avenue Merger and all options that were not exercised prior to the closing were cancelled and the holders of any such options received 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.

As of the consummation of the Avenue Merger, Avenue had 10,445,349 shares of common stock issued and outstanding (including shares of restricted stock) and 101,389 outstanding stock options. As a result, Pinnacle Financial has issued approximately 3.76 million shares of its common stock and paid approximately $20.9 million in cash (including payments related to fractional shares) to the Avenue shareholders and approximately $1.0 million to holders of options to purchase shares of Avenue common stock that were not exercised prior to the consummation of the Avenue Merger.

In addition, upon consummation of the Avenue Merger, Pinnacle Financial assumed 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%. The subordinated notes will be recorded at fair value in connection with purchase accounting and as a result, interest expense will reflect rates that would have been realized if Pinnacle Financial had issued the instruments as of the acquisition date.

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 a combined 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, 8.55% and an additional 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 (Securities Act), and Rule 506 of Regulation D promulgated under the Securities Act. Subsequent to the placement of the 860,470 shares, Pinnacle Financial filed a registration statement on Form S-3 with the SEC 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.

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 managers 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 Financial 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 Financial will not recognize any goodwill or other intangible asset associated with the transaction, however, it will recognize accretion income and amortization expense associated with certain amounts related to the fair value of net assets acquired including the amortizing intangible assets acquired related to BHG's customer list and data processing capabilities, pursuant to 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 the consideration paid and presents the 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 | | $73,186 |
| Goodwill | | 152,444 |
| | | $225,630 |

Acquisition - 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).

The following summarizes the consideration paid and presents a preliminary 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 | | $50,514 |
| Goodwill | | 33,324 |
| | | $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. 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 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 | 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] | 43,526 | 6,046 | 49,572 |
| Total Assets | $1,105,980 | $ (10,760) | $1,095,220 |
| | | | |
| 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 | $85,065 | $ (11,879) | $73,186 |

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, and was increased by $6.3 million during the second quarter of 2016 as a result of the completion of the 2015 tax return.

Magna

| | 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] | 31,057 | 3,976 | 35,033 |
| Total Assets | $582,372 | $ (3,755) | $578,617 |
| | | | |
| 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 | 28,043 | - | 28,043 |
| Total Liabilities | $526,329 | $ 1,774 | $528,103 |
| Net Assets Acquired | $56,043 | $ (5,529) | $50,514 |

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. The value of the deferred tax asset was decreased by $1.9 million as a result of the completion of the 2015 tax return.

(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 Pinnacle Bank's initial investment in BHG, Pinnacle Financial and 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 controls 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.

The equity method of accounting requires that acquired assets and liabilities are recorded at fair value and embedded goodwill and intangibles are identified, tested for impairment and accreted/amortized over their useful life within the equity method investment line of the balance sheet. Accretion income and amortization expense associated with acquired assets is netted within income from equity method investments. At June 30, 2016, Pinnacle Financial has recorded estimated embedded goodwill of $139.1 million and technology, trade name and customer relationship intangibles, net of related amortization, of $15.4 million compared to $50.6 million and $6.1 million, respectively, as of December 31, 2015. Pinnacle Financial 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 June 30, 2016. Amortization expense of $575,000 and $953,000 was included for the three and six months ended June 30, 2016 compared to $600,000 and $1.0 million for the same periods in the prior year. Accretion income of $303,000 and $1.2 million was included in the three and six months ended June 30, 2016. No accretion income was recorded in 2015. During the three and six months ended June 30, 2016, respectively, Pinnacle Financial and Pinnacle Bank received dividends from BHG of $16.5 million and $21.8 million in the aggregate. No dividends were received during the six months ended June 30, 2015. Earnings from BHG are included in Pinnacle Financial's consolidated tax return. Profits from intercompany transactions are eliminated. As part of ongoing business transacted with BHG, Pinnacle Bank purchased loans totaling $2.2 million during the year ended December 31, 2015. No loans were purchased for the period ended June 30, 2016.

A summary of BHG's financial position as of June 30, 2016 and December 31, 2015 and results of operations as of and for the three and six months ended June 30, 2016 and 2015, were as follows (in thousands):

Banker's Healthcare Group
($ in thousands)

| | As of June 30, 2016 | December 31, 2015 |
|---|---|---|
| Assets | $186,535 | 220,578 |
| Liabilities | 127,852 | 137,147 |
| Membership interests | 58,683 | 83,431 |
| Total liabilities and membership | $186,535 | 220,578 |

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Revenues | $39,330 | $34,649 | $70,618 | $61,694 |
| Net income, pre-tax | $21,439 | $21,592 | $33,593 | $35,976 |

Note 4. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at June 30, 2016 and December 31, 2015 are summarized as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| June 30, 2016: | | | | |
| Securities available-for-sale: | | | | |
| U.S. Treasury securities | $- | $ - | $ - | $- |

| | | | | |
|---|---|---|---|---|
| U.S. government agency securities | 97,458 | 69 | 1,080 | 96,447 |
| Mortgage-backed agency securities | 758,714 | 14,042 | 806 | 771,950 |
| State and municipal securities | 159,890 | 9,200 | 13 | 169,077 |
| Asset-backed securities | 68,404 | 2 | 1,062 | 67,344 |
| Corporate notes and other | 4,273 | 136 | 6 | 4,403 |
| | $1,088,739 | $ 23,449 | $ 2,967 | $1,109,221 |
| Securities held-to-maturity: | | | | |
| State and municipal securities | $28,512 | $ 581 | $ - | $29,093 |
| | $28,512 | $ 581 | $ - | $29,093 |

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| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| 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 June 30, 2016, approximately $825.2 million of securities within Pinnacle Financial's investment portfolio were pledged to secure either public funds and other deposits or securities sold under agreements to repurchase. At June 30, 2016, repurchase agreements comprised of secured borrowings totaled $73.3 million and were secured by $73.3 million of pledged U.S. government agency securities, municipal securities, asset backed securities, and corporate debentures. As the fair value of securities pledged to secure repurchase agreements may decline, Pinnacle Financial regularly evaluates its need to pledge additional securities to remain adequately secured.

The amortized cost and fair value of debt securities as of June 30, 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 | |
|---|---|---|---|---|
| June 30, 2016: | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in one year or less | $3,295 | $3,311 | $1,237 | $1,239 |
| Due in one year to five years | 30,553 | 32,539 | 9,522 | 9,624 |
| Due in five years to ten years | 164,910 | 170,595 | 11,296 | 11,621 |
| Due after ten years | 62,863 | 63,482 | 6,457 | 6,609 |
| Mortgage-backed securities | 758,714 | 771,950 | - | - |
| Asset-backed securities | 68,404 | 67,344 | - | - |
| | $1,088,739 | $1,109,221 | $28,512 | $29,093 |

At June 30, 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 June 30, 2016 | | | | | | |
| U.S. Treasury securities | $- | $ - | $- | $ - | $- | $ - |
| U.S. government agency securities | 8,841 | 509 | 12,116 | 571 | 20,957 | 1,080 |
| Mortgage-backed securities | 67,682 | 279 | 41,087 | 527 | 108,769 | 806 |
| State and municipal securities | 2,607 | 12 | 412 | 1 | 3,019 | 13 |
| Asset-backed securities | 38,787 | 409 | 25,554 | 653 | 64,341 | 1,062 |
| Corporate notes | 997 | 6 | - | - | 997 | 6 |
| Total temporarily-impaired securities | $118,914 | $ 1,215 | $79,169 | $ 1,752 | $198,083 | $ 2,967 |
| 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 June 30, 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 June 30, 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 June 30, 2016, Pinnacle Financial had approximately $3.0 million in unrealized losses on $198.1 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 Pinnacle Financial's 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 June 30, 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 June 30, 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.

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 Pinnacle Financial's 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 June 30, 2016, approximately 77.10% of Pinnacle Financial's 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, Pinnacle Financial's 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 Pinnacle Financial's independent loan review department, which reviews a substantial portion of Pinnacle Financial's 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 Pinnacle Financial's 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.

The following table outlines the amount of each loan classification categorized into each risk rating category as of June 30, 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 |
|---|---|---|---|---|---|---|
| June 30, 2016 | | | | | | |
| Accruing loans | | | | | | |
| Pass | $2,423,496 | $1,046,149 | $ 798,597 | $2,402,831 | $244,199 | $6,915,272 |
| Special Mention | 13,781 | 1,869 | 3,896 | 14,835 | - | 34,381 |
| Substandard (1) | 24,538 | 10,134 | 7,073 | 56,291 | 67 | 98,103 |
| Total | 2,461,815 | 1,058,152 | 809,566 | 2,473,957 | 244,266 | 7,047,756 |
| Impaired loans | | | | | | |
| Nonaccrual loans(2) | | | | | | |
| Substandard-nonaccrual | 5,184 | 7,016 | 7,112 | 11,827 | 2,556 | 33,695 |
| Doubtful-nonaccrual | - | - | - | 90 | - | 90 |
| Total nonaccrual loans | 5,184 | 7,016 | 7,112 | 11,917 | 2,556 | 33,785 |
| Troubled debt restructurings(3) | | | | | | |
| Pass | 220 | 1,377 | 3 | 335 | 44 | 1,979 |
| Special Mention | - | 245 | - | - | - | 245 |
| Substandard | - | 1,830 | - | 5,807 | - | 7,637 |
| Total troubled debt restructurings | 220 | 3,452 | 3 | 6,142 | 44 | 9,861 |
| Total impaired loans | 5,404 | 10,468 | 7,115 | 18,059 | 2,600 | 43,646 |
| Total loans | $2,467,219 | $1,068,620 | $ 816,681 | $2,492,016 | $246,866 | $7,091,402 |
| | | | | | | |
| 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 $98.1 million at June 30, 2016, compared to $105.0 million at December 31, 2015.

(2) Included in nonaccrual loans at June 30, 2016 and December 31, 2015 are $9.8 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.

At June 30, 2016 and December 31, 2015, all loans classified as nonaccrual were deemed to be impaired. The principal balances of these nonaccrual loans amounted to $33.8 million and $29.4 million at June 30, 2016 and December 31, 2015, respectively, and are included in the tables above. For the six months ended June 30, 2016, the average balance of nonaccrual loans was $36.6 million compared to $17.3 million for the same period in 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 $41,000 and $88,000, respectively, in interest income from cash payments received on nonaccrual loans during the three and six months ended June 30, 2016, compared to $99,000 and $183,000 during the three and six months ended June 30, 2015. Had these nonaccruing loans been on accruing status, interest income would have been higher by $676,000 and $398,000 for the six months ended June 30, 2016 and 2015, respectively.

The following table details the recorded investment, unpaid principal balance and related allowance of Pinnacle Financial's nonaccrual loans at June 30, 2016 and December 31, 2015 by loan classification (in thousands):

| | At June 30, 2016 | | | At December 31, 2015 | | |
|---|---|---|---|---|---|---|
| | Recorded investment | Unpaid principal balances[(1)] | Related allowance[(2)] | Recorded investment | Unpaid principal balances[(1)] | Related allowance[(2)] |
| Collateral dependent nonaccrual loans: | | | | | | |
| Commercial real estate – mortgage | $3,848 | $ 4,571 | $ - | $4,411 | $5,659 | $ - |
| Consumer real estate – mortgage | 4,059 | 4,585 | - | 5,596 | 6,242 | - |
| Construction and land development | 7,055 | 7,797 | - | 7,531 | 7,883 | - |
| Commercial and industrial | 11,408 | 13,319 | - | 1,420 | 3,151 | - |
| Consumer and other | 382 | 406 | - | - | - | - |
| Total | $26,752 | $ 30,678 | $ - | $18,958 | $22,935 | $ - |
| | | | | | | |
| Cash flow dependent nonaccrual loans: | | | | | | |
| Commercial real estate – mortgage | $1,336 | $ 1,344 | $ 172 | $1,410 | $1,661 | $ 20 |
| Consumer real estate – mortgage | 2,957 | 2,914 | 249 | 3,750 | 4,098 | 616 |
| Construction and land development | 56 | 63 | 224 | 76 | 125 | 12 |
| Commercial and industrial | 510 | 515 | 701 | 263 | 281 | 19 |
| Consumer and other | 2,174 | 2,429 | 134 | 4,902 | 5,341 | 3,002 |
| Total | $7,033 | $ 7,265 | $ 1,480 | $10,401 | $11,506 | $ 3,669 |
| | | | | | | |
| Total nonaccrual loans | $33,785 | $ 37,943 | $ 1,480 | $29,359 | $34,441 | $ 3,669 |

The following table details the average recorded investment and the amount of interest income recognized on a cash basis throughout the three and six months ended June 30, 2016 and 2015, respectively, on Pinnacle Financial's nonaccrual loans that remain on the balance sheets (in thousands):

| | For the three months ended June 30, | | | | For the six months ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2016 | | 2015 | | 2016 | | 2015 | |
| | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| Collateral dependent nonaccrual loans: | | | | | | | | |
| Commercial real estate – mortgage | $3,845 | $ - | $3,205 | $ 53 | $3,474 | $ - | $3,148 | $ 53 |
| Consumer real estate – mortgage | 4,125 | - | 611 | - | 4,140 | - | 617 | - |
| Construction and land development | 7,125 | 41 | 3,219 | 46 | 7,293 | 88 | 3,277 | 130 |
| Commercial and industrial | 12,107 | - | 918 | - | 11,928 | - | 932 | - |
| Consumer and other | 383 | - | - | - | 385 | - | - | - |
| Total | $27,585 | $ 41 | $7,953 | $ 99 | $27,220 | $ 88 | $7,974 | $ 183 |
| Cash flow dependent nonaccrual loans: | | | | | | | | |
| Commercial real estate – mortgage | $1,352 | $ - | $1,804 | $ - | $725 | $ - | $1,824 | $ - |
| Consumer real estate – mortgage | 3,163 | - | 3,982 | - | 3,181 | - | 4,037 | - |
| Construction and land development | 130 | - | 296 | - | 134 | - | 299 | - |
| Commercial and industrial | 1,838 | - | 193 | - | 2,396 | - | 204 | - |
| Consumer and other | 2,936 | - | 3,020 | - | 2,973 | - | 3,003 | - |
| Total | $9,419 | $ - | $9,295 | $ - | $9,409 | $ - | $9,367 | $ - |
| Total nonaccrual loans | $37,004 | $ 41 | $17,248 | $ 99 | $36,629 | $ 88 | $17,341 | $ 183 |

(1) Unpaid principal balance presented net of fair value adjustments recorded in conjunction with purchase accounting.
(2) Collateral dependent loans are typically charged-off to their net realizable value and no specific allowance is carried related to those loans.

Loans acquired with deteriorated credit quality are recorded pursuant to the provisions of ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, and are referred to as purchase credit impaired loans.

The following table provides a rollforward of purchase credit impaired loans from December 31, 2015 through June 30, 2016 (in thousands):

| | Gross Contractual Receivable | Accretable Yield | Nonaccretable Yield | Carrying Value |
|---|---|---|---|---|
| December 31, 2015 | $ 16,274 | $ - | $ (4,143 ) | $12,131 |

| | | | | |
|---|---|---|---|---|
| Year-to-date settlements | (3,063) | - | 668 | (2,395) |
| Additional fundings | 122 | - | - | 122 |
| June 30, 2016 | $ 13,333 | $ - | $ (3,475) | $ 9,858 |

These loans have been deemed to be collateral dependent and as such, no accretable yield has been recorded for these loans. The carrying value is adjusted for additional draws, pursuant to contractual arrangements, offset by loan paydowns. Year-to-date settlements include both loans that were charged-off as well as loans that were paid off, typically as a result of refinancings at other institutions.

Impaired loans also include loans that Pinnacle Bank has elected to formally restructure due to the weakening credit status of a borrower. The restructuring may facilitate a repayment plan that seeks to minimize the potential losses that Pinnacle Bank may otherwise incur. If on nonaccrual status as of the date of restructuring, the loans are included in nonaccrual loans. Loans that have been restructured that were performing as of the restructure date and continue to perform in accordance with the restructured terms are reported separately as troubled debt restructurings.

At June 30, 2016 and December 31, 2015, there were $9.9 million and $8.1 million, respectively, of troubled debt restructurings that were performing as of their restructure date and which were accruing interest. These troubled debt restructurings are considered impaired loans pursuant to U.S. GAAP. Troubled commercial loans are restructured by specialists within our Special Assets Group, and all restructurings are approved by committees and credit officers separate and apart from the normal loan approval process. These specialists are charged with reducing Pinnacle Financial's overall risk and exposure to loss in the event of a restructuring by obtaining some or all of the following: improved documentation, additional guaranties, increase in curtailments, reduction in collateral release terms, additional collateral or other similar strategies.

The following table outlines the amount of each loan category where troubled debt restructurings were made during the three and six months ended June 30, 2016 and 2015 (dollars in thousands):

| | Three months ended June 30, | | | Six months ended June 30, | | |
|---|---|---|---|---|---|---|
| 2016 | Number of contracts | Pre Modification Outstanding Recorded Investment | Post Modification Outstanding Recorded Investment, net of related allowance | Number of contracts | Pre Modification Outstanding Recorded Investment | Post Modification Outstanding Recorded Investment, net of related allowance |
| Commercial real estate – mortgage | - | $ - | $ - | - | $ - | $ - |
| Consumer real estate – mortgage | - | - | - | - | - | - |
| Construction and land development | - | - | - | - | - | - |
| Commercial and industrial | - | - | - | 1 | 2,321 | 1,536 |
| Consumer and other | - | - | - | - | - | - |
| | - | $ - | $ - | 1 | $ 2,321 | $ 1,536 |
| 2015 | | | | | | |
| Commercial real estate – mortgage | - | $ - | $ - | - | $ - | $ - |
| Consumer real estate – mortgage | - | - | - | - | - | - |
| Construction and land development | - | - | - | - | - | - |
| Commercial and industrial | - | - | - | 1 | 434 | 337 |
| Consumer and other | - | - | - | - | - | - |
| | - | $ - | $ - | 1 | $ 434 | $ 337 |

During the three and six months ended June 30, 2016 and 2015, Pinnacle Financial did not have any troubled debt restructurings that subsequently defaulted within twelve months of the restructuring.

The table below presents past due balances by loan classification and segment at June 30, 2016 and December 31, 2015, allocated between accruing and nonaccrual status (in thousands):

| June 30, 2016 | 30-89 days past due and | 90 days or more past due | Total past due and | Nonaccrual[1] | Current and accruing | Total Loans |
|---|---|---|---|---|---|---|

| | accruing | and accruing | accruing | | | |
|---|---|---|---|---|---|---|
| Commercial real estate: | | | | | | |
| Owner-occupied | $ 629 | $ - | $ 629 | $ 4,663 | $ 1,114,819 | $ 1,120,111 |
| All other | 386 | - | 386 | 521 | 1,346,201 | 1,347,108 |
| Consumer real estate – mortgage | 5,476 | 1,046 | 6,522 | 7,016 | 1,055,082 | 1,068,620 |
| Construction and land development | 8,199 | - | 8,199 | 7,112 | 801,370 | 816,681 |
| Commercial and industrial | 1,166 | - | 1,166 | 11,917 | 2,478,933 | 2,492,016 |
| Consumer and other | 6,252 | 577 | 6,829 | 2,556 | 237,481 | 246,866 |
| | $ 22,108 | $ 1,623 | $ 23,731 | $ 33,785 | $ 7,033,886 | $ 7,091,402 |

| December 31, 2015 | 30-89 days past due and accruing | 90 days or more past due and accruing | Total past due and accruing | Nonaccrual[(1)] | Current and accruing | Total Loans |
|---|---|---|---|---|---|---|
| Commercial real estate: | | | | | | |
| Owner-occupied | $ - | $ - | $ - | $ 5,103 | $ 1,078,394 | $ 1,083,497 |
| All other | - | - | - | 718 | 1,191,268 | 1,191,986 |
| Consumer real estate – mortgage | 6,380 | 1,396 | 7,776 | 9,346 | 1,029,395 | 1,046,517 |
| Construction and land development | 309 | - | 309 | 7,607 | 739,781 | 747,697 |
| Commercial and industrial | 4,798 | - | 4,798 | 1,683 | 2,222,061 | 2,228,542 |
| Consumer and other | 6,721 | 373 | 7,094 | 4,902 | 233,000 | 244,996 |
| | $ 18,208 | $ 1,769 | $ 19,977 | $ 29,359 | $ 6,493,899 | $ 6,543,235 |

(1) Approximately $23.7 million and $19.0 million of nonaccrual loans as of June 30, 2016 and December 31, 2015, respectively, were performing pursuant to their contractual terms at those dates.

The following table shows the allowance allocation by loan classification and accrual status at June 30, 2016 and December 31, 2015 (in thousands):

| | | | Impaired Loans | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Accruing Loans | | Nonaccrual Loans | | Troubled Debt Restructurings[(1)] | | Total Allowance for Loan Losses | |
| | June 30, 2016 | December 31, 2015 | June 30, 2016 | December 31, 2015 | June 30, 2016 | December 31, 2015 | June 30, 2016 | December 31, 2015 |
| Commercial real estate –mortgage | $ 13,613 | $ 15,452 | $ 4 | $ 20 | $ 48 | $ 41 | $ 13,665 | $ 15,513 |
| Consumer real estate – mortgage | 6,012 | 6,109 | 131 | 616 | 397 | 495 | 6,540 | 7,220 |
| Construction and land development | 3,920 | 2,891 | 2 | 12 | 1 | - | 3,923 | 2,903 |
| Commercial and industrial | 23,268 | 22,669 | 138 | 19 | 1,684 | 955 | 25,090 | 23,643 |
| Consumer and other | 9,923 | 12,609 | 1,205 | 3,002 | 10 | 5 | 11,138 | 15,616 |
| Unallocated | - | - | - | - | - | - | 1,056 | 537 |
| | $ 56,736 | $ 59,730 | $ 1,480 | $ 3,669 | $ 2,140 | $ 1,496 | $ 61,412 | $ 65,432 |

(1) Troubled debt restructurings of $9.9 million and $8.1 million as of both June 30, 2016 and December 31, 2015, respectively, are classified as impaired loans pursuant to U.S. GAAP; however, these loans continue to accrue interest at contractual rates.

The following table details the changes in the allowance for loan losses from December 31, 2014 to December 31, 2015 to June 30, 2016 by loan classification and the allocation of the allowance for loan losses (in thousands):

| | Commercial real estate – mortgage | Consumer real estate – mortgage | Construction and land development | Commercial and industrial | Consumer and other | Unallocated | Total |
|---|---|---|---|---|---|---|---|
| Allowance for Loan Losses: | | | | | | | |
| Balance at December 31, 2014 | $22,202 | $5,424 | $ 5,724 | $29,167 | $1,570 | $ 3,272 | $67,359 |
| Charged-off loans | (384) | (365) | (190) | (2,207) | (18,002) | - | (21,148) |
| Recovery of previously charged-off loans | 85 | 874 | 1,479 | 1,730 | 5,865 | - | 10,033 |
| Provision for loan losses | (6,390) | 1,287 | (4,110) | (5,047) | 26,183 | (2,735) | 9,188 |
| Balance at December 31, 2015 | $15,513 | $7,220 | $ 2,903 | $23,643 | $15,616 | $ 537 | $65,432 |
| | | | | | | | |
| Collectively evaluated for impairment | $15,452 | $6,109 | $ 2,891 | $22,669 | $12,609 | | $59,730 |
| Individually evaluated for impairment | 61 | 1,111 | 12 | 974 | 3,007 | | 5,165 |
| Loans acquired with deteriorated credit quality | - | - | - | - | - | | - |
| Balance at December 31, 2015 | $15,513 | $7,220 | $ 2,903 | $23,643 | $15,616 | | $65,432 |
| | | | | | | | |
| Loans: | | | | | | | |
| Collectively evaluated for impairment | $2,269,439 | $1,033,479 | $ 740,090 | $2,222,714 | $240,066 | | $6,505,788 |
| Individually evaluated for impairment | 2,420 | 8,986 | 3,689 | 5,288 | 4,930 | | 25,313 |
| Loans acquired with deteriorated credit quality | 3,624 | 4,052 | 3,918 | 540 | - | | 12,134 |
| Balance at December 31, 2015 | $2,275,483 | $1,046,517 | $ 747,697 | $2,228,542 | $244,996 | | $6,543,235 |
| | | | | | | | |
| Allowance for Loan Losses: | | | | | | | |
| Balance at December 31, 2015 | $15,513 | $7,220 | $2,903 | $23,643 | $15,616 | $537 | $65,432 |
| Charged-off loans | (196) | (379) | - | (2,243) | (13,555) | - | (16,373) |
| Recovery of previously charged-off loans | 193 | 156 | 106 | 1,615 | 1,109 | - | 3,179 |
| Provision for loan losses | (1,845) | (457) | 914 | 2,075 | 7,968 | 519 | 9,174 |
| Balance at June 30, 2016 | $13,665 | $6,540 | $3,923 | $25,090 | $11,138 | $1,056 | $61,412 |
| | | | | | | | |
| Collectively evaluated for impairment | $13,613 | $6,012 | $3,920 | $23,268 | $9,923 | | $56,736 |
| Individually evaluated for impairment | 52 | 528 | 3 | 1,822 | 1,215 | | 3,620 |
| Loans acquired with deteriorated credit quality | - | - | - | - | - | | - |
| Balance at June 30, 2016 | $13,665 | $6,540 | $3,923 | $25,090 | $11,138 | | $61,412 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Loans: | | | | | | | |
| Collectively evaluated for impairment | $2,461,815 | $1,058,152 | $809,566 | $2,473,957 | $244,266 | | $7,047,756 |
| Individually evaluated for impairment | 1,922 | 8,068 | 4,129 | 17,483 | 2,219 | | 33,821 |
| Loans acquired with deteriorated credit quality | 3,482 | 2,400 | 2,986 | 576 | 381 | | 9,825 |
| Balance at June 30, 2016 | $2,467,219 | $1,068,620 | $816,681 | $2,492,016 | $246,866 | | $7,091,402 |

The adequacy of the allowance for loan losses is assessed at the end of each calendar quarter using a migration analysis compiled using loss data over the previous 24 quarters. The level of the allowance is based upon evaluation of the loan portfolio, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, historical loss experience, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations. The allowance for loan losses for purchased loans is calculated similarly to the method utilized for legacy Pinnacle Bank loans. Pinnacle Financial's accounting policy is to compare the computed allowance for loan losses for purchased loans to any remaining fair value adjustment. If the computed allowance is greater than the remaining fair value adjustment, the excess is added to the allowance for loan losses by a charge to the provision for loan losses.

Pinnacle Financial analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any industry. Pinnacle Financial utilizes broadly accepted industry classification systems in order to classify borrowers into various industry classifications. Pinnacle Financial has a credit exposure (loans outstanding plus unfunded lines of credit) exceeding 25% of Pinnacle Bank's total risk-based capital to borrowers in the following industries at June 30, 2016 with the comparative exposures for December 31, 2015 (in thousands):

| | at June 30, 2016 | | | |
|---|---|---|---|---|
| | Outstanding Principal Balances | Unfunded Commitments | Total exposure | Total Exposure at December 31, 2015 |
| Lessors of nonresidential buildings | $945,924 | $ 274,357 | $1,220,281 | $1,078,211 |
| Lessors of residential buildings | 432,711 | 189,627 | 622,338 | 500,266 |

At June 30, 2016, Pinnacle Bank had granted loans and other extensions of credit amounting to approximately $8.8 million to current directors, executive officers, and their related entities, of which $5.9 million had been drawn upon. At December 31, 2015, Pinnacle Bank had granted loans and other extensions of credit amounting to approximately $14.5 million to directors, executive officers, and their related entities, of which approximately $11.4 million had been drawn upon. None of these loans to directors, executive officers, and their related entities were impaired at June 30, 2016 or December 31, 2015.

At June 30, 2016, Pinnacle Financial had approximately $9.3 million in commercial loans held for sale. These loans held for sale consist solely of apartment loans originated for sale to a third-party as part of a multi-family loan program. Such loans are closed under a pass-through commitment structure wherein Pinnacle Bank's loan commitment to the borrower is the same as the third party's take-out commitment to Pinnacle Bank, and the third party purchase typically occurs within thirty days of Pinnacle Bank closing with the borrowers.

Residential Lending

At June 30, 2016, Pinnacle Financial had approximately $53.1 million of mortgage loans held-for-sale compared to approximately $47.9 million at December 31, 2015. Total loan volumes sold during the six months ended June 30, 2016 were approximately $198.2 million compared to approximately $208.4 million for the six months ended June 30, 2015. During the six months ended June 30, 2016, Pinnacle Financial recognized $7.8 million in gains on the sale of these loans, net of commissions paid, compared to $3.6 million during the six months ended June 30, 2015.

These mortgage loans held-for-sale are originated internally and are primarily to borrowers in Pinnacle Bank's geographic markets. These sales are typically on a mandatory basis to investors that follow conventional government sponsored entities (GSE) and the Department of Housing and Urban Development/U.S. Department of Veterans

Affairs (HUD/VA) guidelines.

Each purchaser has specific guidelines and criteria for sellers of loans, and the risk of credit loss with regard to the principal amount of the loans sold is generally transferred to the purchasers upon sale. While the loans are sold without recourse, the purchase agreements require Pinnacle Bank to make certain representations and warranties regarding the existence and sufficiency of file documentation and the absence of fraud by borrowers or other third parties such as appraisers in connection with obtaining the loan. If it is determined that the loans sold were in breach of these representations or warranties, Pinnacle Bank has obligations to either repurchase the loan for the unpaid principal balance and related investor fees or make the purchaser whole for the economic benefits of the loan. To date, repurchase activity pursuant to the terms of these representations and warranties has been insignificant to Pinnacle Bank.

Note 6. Income Taxes

ASC 740, Income Taxes, defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. This section also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, and includes guidance concerning accounting for income tax uncertainties in interim periods.

A reconciliation of the beginning and ending unrecognized tax benefit related to uncertain tax positions is as follows (in thousands):

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Beginning of period | $196 | $391 | $196 | $391 |
| Increases due to tax positions taken during the current year | - | - | - | - |
| Increases due to tax positions taken during a prior year | - | - | - | - |
| Decreases due to the lapse of the statute of limitations during the current year | - | - | - | - |
| Decreases due to settlements with the taxing authorities during the current year | - | - | - | - |
| Balance at June 30, | $196 | $391 | $196 | $391 |

Pinnacle Financial's policy is to recognize interest and/or penalties related to income tax matters in income tax expense. The total amount of interest and penalties recorded in the income statement for the three and six months ended June 30, 2015 was $9,600 and $19,600, respectively. No interest and penalties were recorded for the three and six months ended June 30, 2016.

Pinnacle Financial's effective tax rate for the three and six months ended June 30, 2016 was 33.9% and 33.5%, respectively, compared to 33.2% and 33.1%, respectively, for the three and six months ended June 30, 2015. The difference between the effective tax rate and the Federal and State income tax statutory rate of 39.23% is primarily attributable to our investments in bank qualified municipal securities, investments in low-rate housing loans that qualify for Tennessee state excise tax credits and bank-owned life insurance, offset in part by meals and entertainment, a portion of which is non-deductible.

Note 7. Commitments and Contingent Liabilities

In the normal course of business, Pinnacle Financial has entered into off-balance sheet financial instruments which include commitments to extend credit (i.e., including unfunded lines of credit) and standby letters of credit. Commitments to extend credit are usually the result of lines of credit granted to existing borrowers under agreements that the total outstanding indebtedness will not exceed a specific amount during the term of the indebtedness. Typical borrowers are commercial concerns that use lines of credit to supplement their treasury management functions, and thus their total outstanding indebtedness may fluctuate during any time period based on the seasonality of their business and the resultant timing of their cash flows. Other typical lines of credit are related to home equity loans granted to consumers. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At June 30, 2016, these commitments amounted to $2.5 billion.

Standby letters of credit are generally issued on behalf of an applicant (our customer) to a specifically named beneficiary and are the result of a particular business arrangement that exists between the applicant and the beneficiary. Standby letters of credit have fixed expiration dates and are usually for terms of two years or less unless terminated beforehand due to criteria specified in the standby letter of credit. A typical arrangement involves the applicant routinely being indebted to the beneficiary for such items as inventory purchases, insurance, utilities, lease guarantees or other third party commercial transactions. The standby letter of credit would permit the beneficiary to obtain payment from Pinnacle Financial under certain prescribed circumstances. Subsequently, Pinnacle Financial would then seek reimbursement from the applicant pursuant to the terms of the standby letter of credit. At June 30, 2016, these commitments amounted to $101.8 million.

Pinnacle Financial follows the same credit policies and underwriting practices when making these commitments as it does for on-balance sheet instruments. Each customer's creditworthiness is evaluated on a case-by-case basis, and the amount of collateral obtained, if any, is based on management's credit evaluation of the customer. Collateral held varies but may include cash, real estate and improvements, marketable securities, accounts receivable, inventory, equipment and personal property.

The contractual amounts of these commitments are not reflected in the consolidated financial statements and only amounts drawn upon would be reflected in the future. Since many of the commitments are expected to expire without being drawn upon, the contractual amounts do not necessarily represent future cash requirements. However, should the commitments be drawn upon and should Pinnacle Financial's customers default on their resulting obligation to Pinnacle Financial, the maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those commitments. At June 30, 2016 and December 31, 2015, Pinnacle Financial had accrued $1.2 million and $1.4 million, respectively, for the inherent risks associated with these off-balance sheet commitments.

On May 9, 2016 a purported class action complaint was filed in the Chancery Court for the State of Tennessee, 20th Judicial District at Nashville, styled Stephen Bushansky, on behalf of himself and all others similarly situated, Plaintiff, versus Avenue Financial Holdings, Inc. Ronald L. Samuels, Kent Cleaver, David G. Anderson, Agenia Clark, James F. Deutsch, Marty Dickens, Patrick G. Emery, Nancy Falls, Joseph C. Galante, David Ingram. Stephen Moore, Ken Robold, Karen Saul and Pinnacle Financial Partners, Inc., Defendants (Case No. 16-489-IV), alleging that the individual defendants breached their fiduciary duties by, among other things, approving the sale of Avenue for an inadequate price as the result of a flawed sales process, agreeing to the inclusion of unreasonable deal protection devices in the Merger Agreement, approving the Avenue Merger in order to receive benefits not equally shared by all other shareholders of Avenue, and issuing materially misleading and incomplete disclosures to Avenue's shareholders. The lawsuit also alleges claims against Avenue and Pinnacle for aiding and abetting the individual defendants' breaches of fiduciary duties.

The plaintiff purports to seek class-wide relief, including but not limited to: monetary damages, and an award of interest, attorney's fees, and expenses. On May 18, 2016, the Bushansky litigation was transferred to the Davidson County, Tennessee Business Court Pilot Project (Business Court).

To avoid the costs, risks and uncertainties inherent in litigation, on June 10, 2016, the defendants entered into a memorandum of understanding with the plaintiff regarding settlement of the Bushansky litigation (the "memorandum of understanding"). The memorandum of understanding outlines the terms of the parties' agreement in principle to settle and release all claims which were or could have been asserted in the Bushansky action. In consideration for the settlement of the Bushansky litigation and release of claims contemplated thereby, the parties to the action agreed that Avenue and Pinnacle would make certain supplemental disclosures to the definitive proxy statement/prospectus. The memorandum of understanding contemplates that the parties will attempt in good faith to agree promptly upon a stipulation of settlement to be submitted to the Business Court for approval at the earliest practicable time. The stipulation of settlement will be subject to approval by the Business Court, which will consider the fairness, reasonableness and adequacy of such settlement. Under the terms of the proposed settlement, following final approval by the Business Court, the action will be dismissed with prejudice. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the Business Court will approve the settlement even if the parties were to enter into such stipulation. In such event, the proposed settlement will be null and void and of no force and effect.

Pinnacle Financial believes the claims asserted in the Bushansky action are without merit and intends to continue to defend the litigation. At this time though, it is not possible to predict the outcome of the proceeding or its impact on Pinnacle Financial.

Various legal claims also arise from time to time in the normal course of business. In the opinion of management, the resolution of these claims outstanding at June 30, 2016 will not have a material adverse impact on Pinnacle Financial's consolidated financial condition, operating results or cash flows.

Note 8. Stock Options, Stock Appreciation Rights and Restricted Shares

As described more fully in the Annual Report on Form 10-K, as of June 30, 2016, Pinnacle Financial has one equity incentive plan under which it is able to grant awards, the 2014 Equity Incentive Plan (2014 Plan) and has assumed the stock option plan of CapitalMark (the CapitalMark Option Plan) in connection with the CapitalMark Merger. In addition, awards previously granted remain outstanding under equity plans previously adopted by Pinnacle Financial's Board of Directors or assumed in connection with acquisitions of Mid-America Bancshares, Inc. and Cavalry Bancorp, Inc. No new awards may be granted under these other plans or the CapitalMark Option Plan.

Total shares available for issuance under the 2014 Plan were approximately 1.0 million shares as of June 30, 2016, inclusive of shares returned to plan reserves during the six months ended June 30, 2016. The 2014 Plan also permits Pinnacle Financial to reissue awards currently outstanding that are subsequently forfeited, settled in cash or expired unexercised and returned to the 2014 Plan.

Common Stock Options and Stock Appreciation Rights

As of June 30, 2016, there were 916,745 stock options and 2,481 stock appreciation rights (SARS) outstanding to purchase common shares. A summary of the stock option and stock appreciation rights activity within the equity incentive plans during the six months ended June 30, 2016 and information regarding expected vesting, contractual terms remaining, intrinsic values and other matters is as follows:

| | Number | Weighted-Average Exercise Price | Weighted-Average Contractual Remaining Term (in years) | Aggregate Intrinsic Value (000's) |
|---|---|---|---|---|
| Outstanding at December 31, 2015 | 1,251,601 | $ 21.23 | 2.54 | $ 37,714 (1) |
| Granted | - | | | |
| Exercised | (331,865 ) | | | |
| Stock appreciation rights exercised | (510 ) | | | |
| Forfeited | - | | | |
| Outstanding at June 30, 2016 | 919,226 | $ 21.60 | 2.59 | $ 25,049 (2) |
| Options exercisable at June 30, 2016 | 919,226 | $ 21.60 | 2.59 | $ 25,049 (2) |

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted closing price of Pinnacle Financial common stock of $51.36 per common share at December 31, 2015 for the 1,251,601 options and stock appreciation rights that were in-the-money at December 31, 2015.

(2) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted closing price of Pinnacle Financial common stock of $48.85 per common share at June 30, 2016 for the 919,226 options and stock appreciation rights that were in-the-money at June 30, 2016.

(3) 510 SARS were converted into 229 common shares upon exercise.

Compensation costs related to unvested stock options granted under Pinnacle Financial's equity incentive plan have been fully recognized and all outstanding option awards are fully vested.

Restricted Share Awards

Additionally, the 2014 Plan provides for the granting of restricted share awards and other performance or market-based awards. There were no market-based awards outstanding as of June 30, 2016 under this plan.

Pinnacle Financial grants restricted share awards to associates, executive management and outside directors with a combination of time and, in the case of executive management, performance vesting criteria. The following table outlines restricted stock grants that were made, grouped by similar vesting criteria, during the six months ended June 30, 2016:

| Grant Year | Group[1] | Vesting Period in years | Shares awarded | Restrictions Lapsed and shares released to participants | Shares Forfeited by participants[5] | Shares Unvested |
|---|---|---|---|---|---|---|
| Time Based Awards | | | | | | |
| 2016 | Associates[2] | 5 | 96,294 | 166 | 2,413 | 93,715 |
| Performance Based Awards | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 2016 | Leadership team(3) | -(3) | 43,694 | - | - | 43,694 |
| Outside Director Awards(4) | | | | | | |
| 2016 | Outside directors | 1 | 16,604 | - | 1,186 | 15,418 |

(1) Groups include employees (referred to as associates above), the leadership team which includes our named executive officers and other key senior leadership members, and outside directors. When the restricted shares are awarded, a participant receives voting rights and forfeitable dividend rights with respect to the shares, but is not able to transfer the shares until the restrictions have lapsed. Once the restrictions lapse, the participant is taxed on the value of the award and may elect to sell some shares to pay the applicable income taxes associated with the award. For time-based restricted share awards, dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by Pinnacle Financial at the time of termination. For performance-based awards, dividends are placed into escrow until the forfeiture restrictions on such shares lapse.

(2) The forfeiture restrictions on these restricted share awards lapse in equal annual installments on the anniversary date of the grant.

(3) Reflects conversion of restricted share units issued in prior years to restricted share awards. The forfeiture restrictions on these restricted share awards lapse in separate equal installments should Pinnacle Financial achieve certain soundness targets over each year of the subsequent vesting period. Half of the awards include a four year vesting period while the remainder include a three year vesting period.

(4) Restricted share awards are issued to the outside members of the board of directors in accordance with their board compensation plan. Restrictions lapse on February 28, 2017 based on each individual board member meeting their attendance goals for the various board and board committee meetings to which each member was scheduled to attend.

(5) These shares represent forfeitures resulting from recipients whose employment terminated during the year-to-date period ended June 30, 2016. Any dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by Pinnacle Financial at the time of termination.

A summary of activity for unvested restricted share awards for the six months ended June 30, 2016 is as follows:

| | Number | Grant Date Weighted-Average Cost |
|---|---|---|
| Unvested at December 31, 2015 | 866,314 | $ 31.39 |
| Shares awarded | 112,898 | |
| Conversion of restricted share units to restricted share awards | 43,694 | |
| Restrictions lapsed and shares released to associates/directors | (203,588) | |
| Shares forfeited[1] | (15,261) | |
| Unvested at June 30, 2016 | 804,057 | $ 36.02 |

(1) Represents shares forfeited due to employee termination and/or retirement. No shares were forfeited due to failure to meet performance targets.

Compensation expense associated with the time-based restricted share awards is recognized over the time period that the restrictions associated with the awards lapse on a straight-line basis based on the total grant date fair value. Compensation expense associated with performance-based restricted share awards is recognized over the time period that the restrictions associated with the awards are anticipated to lapse based on a schedule consistent with the nature of the award. For the three and six months ended June 30, 2016, Pinnacle Financial recognized approximately $1.8 million and $3.7 million, respectively, in compensation costs attributable to restricted share awards, compared to $1.4 million and $2.7 million for the three and six months ended June 30, 2015.

Restricted Share Units

Pinnacle Financial grants restricted share units to the senior executive officers and other members of the Leadership Team annually. The senior executive officers' restricted share unit award typically includes a range of shares that may be earned from the target level of performance to the maximum level of performance. The Leadership Team awards are granted at the target level of performance. Restricted share units awarded prior to 2015 will convert to a number of restricted share awards based on the achievement of certain performance metrics for each of the fiscal years to which the award relates, with the restrictions on the restricted shares lapsing if Pinnacle Bank achieves certain soundness levels in subsequent years. Beginning with grants made in 2015, the awards will be settled in shares of freely tradeable common stock of Pinnacle Financial if the one-year performance metrics and subsequent one-year service period requirements are met and subsequent soundness targets are achieved. The performance metrics for each of the performance periods is established concurrently with the award of the restricted share unit grants by the Human Resources and Compensation Committee. The awards may be issued with a post-vest holding period, as shown below. During the post-vest holding period, the shares will not be released to the recipient and cannot be transferred, subject to limited exceptions, but will continue to accrue dividends until the awards are released, which is expected to be commensurate with the filing of Pinnacle Financial's Annual Report on Form 10-K for the prescribed year. These restricted share units are being expensed based on the requisite service period of the underlying tranche of the award. Each period, the number of shares that is expected to lapse to the recipient is reevaluated and the associated compensation expense is adjusted accordingly. The expense is accrued using an anticipated performance level for the senior executive officers between the target and maximum performance levels and at the target performance level for the Leadership Team.

The following table details the Restricted Stock Unit awards outstanding at June 30, 2016:

| | Units Awarded | | | | | |
|---|---|---|---|---|---|---|
| Grant year | Named Executive Officers (NEOs)[1] | Leadership Team other than NEOs | Applicable Performance Periods associated with each tranche (fiscal year) | Service period per tranch (in years) | Holding period per tranche (in years) | Shares settled into RSAs as of period end[2] |
| 2016 | 73,474-110,223 | 26,683 | 2016 | 2 | 3 | N/A |
| | | | 2017 | 2 | 2 | N/A |
| | | | 2018 | 2 | 1 | N/A |
| 2015 | 58,200-101,850 | 28,378 | 2015 | 2 | 3 | N/A |
| | | | 2016 | 2 | 2 | N/A |
| | | | 2017 | 2 | 1 | N/A |
| 2014[3] | 58,404-102,209 | 29,087 | 2014 | 5 | N/A | 21,856 |
| | | | 2014 | 4 | N/A | 21,856 |
| | | | 2015 | 4 | N/A | 21,847 |
| | | | 2015 | 3 | N/A | 21,847 |
| | | | 2016 | 3 | N/A | |
| | | | 2016 | 2 | N/A | |

(1) The named executive officers are awarded a range of awards that may be earned based on attainment of goals at a target level of performance to the maximum level of performance.

(2) Restricted stock unit awards granted in 2016 and 2015 will be earned and settled in shares of Pinnacle Financial common stock.

(3) Restrictions on half of the shares previously converted to RSAs will lapse commensurate with the filing of the Form 10-K for the year ended December 31, 2017 and 2018, respectively.

Stock compensation expense related to restricted stock units totaled $817,000 and $1.6 million for the three and six months ended June 30, 2016, respectively, compared to $336,000 and $634,000 for the three and six months ended June 30, 2015, respectively.

Note 9. Regulatory Matters

Pursuant to Tennessee banking law, Pinnacle Bank may not, without the prior consent of the Commissioner of the Tennessee Department of Financial Institutions (TDFI), pay any dividends to Pinnacle Financial in a calendar year in excess of the total of Pinnacle Bank's retained net income for that year plus the retained net income for the preceding two years. During the six months ended June 30, 2016, Pinnacle Bank paid $12.9 million in dividends to Pinnacle Financial. Pinnacle Financial increased its quarterly common stock dividend to $0.14 beginning in the first quarter of 2016. The amount and timing of all future dividend payments, if any, is subject to Board discretion and will depend on Pinnacle Financial's earnings, capital position, financial condition and other factors, including new regulatory capital requirements, as they become known to Pinnacle Financial.

Pinnacle Financial and Pinnacle Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions, by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Pinnacle

Financial and Pinnacle Bank must meet specific guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

The minimum capital level requirements applicable to bank holding companies and banks are:

(i) a common equity Tier 1 capital ratio of 4.5%;
(ii) a Tier 1 risk-based capital ratio of 6%;
(iii) a total risk-based capital ratio of 8%; and
(iv) a Tier 1 leverage ratio of 4% for all institutions.

The capital level requirements also establish a "capital conservation buffer" of 2.5% (to be phased in over three years) above the regulatory minimum risk-based capital ratios, and result in the following required ratios once the capital conservation buffer is fully phased in:

(i) a common equity Tier 1 risk-based capital ratio of 7%;
(ii) a Tier 1 risk-based capital ratio of 8.5%; and
(iii) a total risk-based capital ratio of 10.5%.

As of January 1, 2016, compliance with the capital conservation buffer is determined by increasing the capital ratio minimum by 0.625% for the capital ratio with the least spread between regulatory minimum and calculated ratios. The buffer will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

To be considered well capitalized under applicable banking regulations, Pinnacle Financial and Pinnacle Bank must maintain the following minimum capital ratios and not be subject to a written agreement, order or directive to maintain a higher capital level:

(i) a common equity Tier 1 capital ratio of 6.5%;
(ii) a Tier 1 risk based capital ratio of 8%;
(iii) a Total risk based capital ratio of 10%; and
(iv) in the case of Pinnacle Bank, a Tier 1 leverage ratio of 5%.

Under capital level requirements, Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. Cumulative preferred stock and trust preferred securities issued after May 19, 2010, will no longer qualify as Tier 1 capital, but such securities issued prior to May 19, 2010, including in the case of bank holding companies with less than $15.0 billion in total assets, trust preferred securities issued prior to that date, will continue to count as Tier 1 capital subject to certain limitations. As a result, Pinnacle Financial's Trust Preferred Securities continue to qualify as Tier 1 capital. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

Common equity Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions.

The current capital level requirements allow banks and their holding companies with less than $250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Each of Pinnacle Financial and Pinnacle Bank has opted-out of this requirement.

Management believes, as of June 30, 2016, that Pinnacle Financial and Pinnacle Bank met all capital adequacy requirements to which they are subject. To be categorized as well-capitalized under applicable banking regulations, Pinnacle Financial and Pinnacle Bank must maintain minimum total risk-based, Tier I risk-based, common equity Tier I and Tier I leverage ratios as set forth in the following table and not be subject to a written agreement, order or directive to maintain a higher capital level. Pinnacle Financial's and Pinnacle Bank's actual capital amounts and ratios are presented in the following table (in thousands):

| | Actual | | Minimum Capital Requirement | | Minimum To Be Well-Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| At June 30, 2016 | | | | | | |
| Total capital to risk weighted assets: | | | | | | |
| Pinnacle Financial | $951,868 | 11.1 % | $688,798 | 8.0 % | $860,997 | 10.0 % |
| Pinnacle Bank | $910,455 | 10.6 % | $686,692 | 8.0 % | $858,364 | 10.0 % |
| Tier I capital to risk weighted assets: | | | | | | |
| Pinnacle Financial | $761,868 | 8.8 % | $516,598 | 6.0 % | $688,798 | 8.0 % |
| Pinnacle Bank | $720,456 | 8.4 % | $515,019 | 6.0 % | $686,692 | 8.0 % |
| Common equity Tier I capital to risk weighted assets | | | | | | |
| Pinnacle Financial | $681,746 | 7.9 % | $387,449 | 4.5 % | $559,648 | 6.5 % |
| Pinnacle Bank | $720,333 | 8.4 % | $386,264 | 4.5 % | $557,937 | 6.5 % |
| Tier I capital to average assets (*): | | | | | | |
| Pinnacle Financial | $761,868 | 8.7 % | $348,653 | 4.0 % | N/A | N/A |
| Pinnacle Bank | $720,456 | 8.3 % | $347,549 | 4.0 % | $434,436 | 5.0 % |

(*) Average assets for the above calculations were based on the most recent quarter.

Note 10. Derivative Instruments

Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current period earnings.

Non-hedge derivatives

Pinnacle Financial enters into interest rate swaps (swaps) to facilitate customer transactions and meet their financing needs. Upon entering into these instruments to meet customer needs, Pinnacle Financial enters into offsetting positions in order to minimize the risk to Pinnacle Financial. These swaps are derivatives, but are not designated as hedging instruments.

Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counter party or customer owes Pinnacle Financial, and results in credit risk to Pinnacle Financial. When the fair value of a derivative instrument contract is negative, Pinnacle Financial owes the customer or counterparty and therefore, has no credit risk.

A summary of Pinnacle Financial's interest rate swaps related to customers as of June 30, 2016 and December 31, 2015 is included in the following table (in thousands):

| June 30, 2016 | | December 31, 2015 |
|---|---|---|
| Notional | Estimated | Notional |

| | Amount | Fair Value | Amount | Estimated Fair Value |
|---|---|---|---|---|
| Interest rate swap agreements: | | | | |
| Pay fixed / receive variable swaps | $577,923 | $37,589 | $396,112 | $16,130 |
| Pay variable / receive fixed swaps | 577,923 | (37,880 ) | 396,112 | (16,329 ) |
| Total | $1,155,846 | $(291 ) | $792,224 | $(199 ) |

Hedge derivatives

Pinnacle Financial has forward cash flow hedge relationships to manage future interest rate exposure. The hedging strategy converts the LIBOR based variable interest rate on forecasted borrowings to a fixed interest rate and protects Pinnacle Financial from floating interest rate variability. The initial hedge relationships were entered into during the second quarter of 2013. During the third quarter of 2014, Pinnacle Financial terminated three individual contracts of the initial hedge relationships based on changes in internal forecasts for future interest rates. As a result of terminating these contracts, Pinnacle Financial will incur a gain of $64,000 over the original terms of these agreements which were scheduled to begin in April 2015. Pinnacle Financial has since entered into additional forward cash flow hedge relationships for interest rate risk management purposes given the aforementioned changes in forecasted interest rates. The terms of the individual contracts within the relationship are as follows (in thousands):

| | | | | | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|---|---|---|---|
| | Forecasted Notional Amount | Receive Rate | Pay Rate | Term[(1)] | Asset/ (Liabilities) | Unrealized Loss in Accumulated Other Comprehensive Income | Asset/ (Liabilities) | Unrealized Loss in Accumulated Other Comprehensive Income |
| Interest Rate Swap | $ 33,000 | 3 month LIBOR | 2.265 % | April 2016- April 2020 | (1,785 ) | (1,085 ) | (784 ) | (476 ) |
| Interest Rate Swap | 33,000 | 3 month LIBOR | 2.646 % | April 2016- April 2022 | (3,051 ) | (1,854 ) | (1,478 ) | (898 ) |
| Interest Rate Swap | 33,000 | 3 month LIBOR | 2.523 % | Oct. 2016- Oct. 2020 | (2,048 ) | (1,245 ) | (908 ) | (552 ) |
| Interest Rate Swap | 33,000 | 3 month LIBOR | 2.992 % | Oct. 2017- Oct. 2021 | (2,466 ) | (1,499 ) | (1,112 ) | (676 ) |
| Interest Rate Swap | 34,000 | 3 month LIBOR | 3.118 % | April 2018- July 2022 | (2,626 ) | (1,596 ) | (1,170 ) | (711 ) |
| Interest Rate Swap | 34,000 | 3 month LIBOR | 3.158 % | July 2018- Oct. 2022 | (2,611 ) | (1,587 ) | (1,158 ) | (704 ) |
| | $ 200,000 | | | | (14,587 ) | (8,866 ) | (6,610 ) | (4,017 ) |

(1) No cash will be exchanged prior to the beginning of the term.

Pinnacle Financial has seven interest rate swap agreements designated as cash flow hedges intended to protect against the variability of cash flows on selected LIBOR based loans. The swaps hedge the interest rate risk, wherein Pinnacle Financial receives a fixed rate of interest from a counterparty and pays a variable rate, based on one month LIBOR. The terms of the respective swaps range from seven to ten years and started on July 1, 2014. The swaps were entered into with a counterparty that met Pinnacle Financial's credit standards and the agreements contain collateral provisions protecting the at-risk party. Pinnacle Financial believes that the credit risk inherent in the contract is not significant.

| | | | | | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|---|---|---|---|
| | Forecasted Notional Amount | Receive Rate | Pay Rate | Term[(2)] | Asset/ (Liabilities) | Unrealized Gain in Accumulated Other Comprehensive Income | Asset/ (Liabilities) | Unrealized Gain (Loss) in Accumulated Other Comprehensive Income |
| Interest Rate Swap | $ 27,500 | 2.090 % | 1 month LIBOR | July 2014 - July 2021 | 1,553 | 944 | 663 | 403 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Interest Rate Swap | 25,000 | 2.270% | 1 month LIBOR | July 2014 - July 2022 | 2,178 | 1,324 | 968 | 588 |
| Interest Rate Swap | 27,500 | 2.420% | 1 month LIBOR | July 2014 - July 2023 | 2,859 | 1,737 | 1,320 | 802 |
| Interest Rate Swap | 30,000 | 2.500% | 1 month LIBOR | July 2014 - July 2024 | 2,964 | 1,801 | 1,333 | 810 |
| Interest Rate Swap | - | 1.048% | 1 month LIBOR | August 2015 - August 2018 | - | - | (46) | (28) |
| Interest Rate Swap | - | 1.281% | 1 month LIBOR | August 2015 - August 2019 | - | - | (34) | (21) |
| Interest Rate Swap | 15,000 | 1.470% | 1 month LIBOR | August 2015 - August 2020 | 448 | 272 | (14) | (9) |
| | $125,000 | | | | 10,002 | 6,078 | 4,190 | 2,545 |

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The cash flow hedges were determined to be fully effective during the period presented. Therefore, no amount of ineffectiveness has been included in net income. The aggregate fair value of the swaps is recorded in other assets or other liabilities with changes in fair value recorded in accumulated other comprehensive (loss) income, net of tax. If a hedge was deemed to be ineffective, the amount included in accumulated other comprehensive (loss) income would be reclassified into a line item within the statement of income that impacts operating results. The hedge would no longer be considered effective if a portion of the hedge becomes ineffective, the item hedged is no longer in existence or Pinnacle Financial discontinues hedge accounting. Pinnacle Financial expects the hedges to remain fully effective during the remaining terms of the swaps. Pinnacle Financial does not expect any amounts to be reclassified from accumulated other comprehensive (loss) income related to these swaps over the next twelve months.

Note 11. Fair Value of Financial Instruments

FASB ASC 820, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability.

Valuation Hierarchy

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Following is a description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Assets

Securities available-for-sale – Where quoted prices are available for identical securities in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and certain other financial products. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation and more complex pricing models or discounted cash flows are used, securities are classified within Level 3 of the valuation hierarchy.

Other investments – Included in others assets are other investments recorded at fair value primarily in certain nonpublic private equity funds. The valuation of nonpublic private equity investments requires management judgment due to the absence of observable quoted market prices, inherent lack of liquidity and the long-term nature of such assets. These investments are valued initially based upon transaction price. The carrying values of other investments are adjusted either upwards or downwards from the transaction price to reflect expected exit values as evidenced by financing and sale transactions with third parties, or when determination of a valuation adjustment is confirmed through ongoing reviews by senior investment managers. A variety of factors are reviewed and monitored to assess positive and negative changes in valuation including, but not limited to, current operating performance and future expectations of the particular investment, industry valuations of comparable public companies and changes in market outlook and the third-party financing environment over time. In determining valuation adjustments resulting from the investment review process, emphasis is placed on current company performance and market conditions. These investments are included in Level 3 of the valuation hierarchy as these funds are not widely traded and the underlying investments of such funds are often privately-held and/or start-up companies for which market values are not readily available.

Other assets – Included in other assets are certain assets carried at fair value, including interest rate swap agreements, the cash flow hedge and interest rate locks associated with the mortgage loan pipeline. The carrying amount of interest rate swap agreements is based on Pinnacle Financial's pricing models that utilize observable market inputs. The fair value of the cash flow hedge is determined by calculating the difference between the discounted fixed rate cash flows and the discounted variable rate cash flows. The fair value of the mortgage loan pipeline is based upon the projected sales price of the underlying loans, taking into account market interest rates and other market factors at the measurement date, net of the projected fallout rate. Pinnacle Financial reflects these assets within Level 2 of the valuation hierarchy as these assets are valued using similar transactions that occur in the market.

Collateral dependent nonaccrual loans – A loan is classified as nonaccrual when it is probable Pinnacle Financial will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Nonaccrual loans are measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent. If the recorded investment in the nonaccrual loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses or the difference may be recognized as a charge-off. Nonaccrual loans are classified within Level 3 of the hierarchy due to the unobservable inputs used in determining their fair value such as collateral values and the borrower's underlying financial condition.

Other real estate owned – Other real estate owned (OREO) represents real estate foreclosed upon by Pinnacle Bank through loan defaults by customers or acquired by deed in lieu of foreclosure. Substantially all of these amounts relate to lots, homes and development projects that are either completed or are in various stages of construction for which Pinnacle Financial believes it has adequate collateral. Upon foreclosure, the property is recorded at the lower of cost or fair value, based on appraised value, less selling costs estimated as of the date acquired with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent valuation downward adjustments are determined on a specific property basis and are included as a component of noninterest expense along with holding costs. Any gains or losses realized at the time of disposal are also reflected in noninterest expense, as applicable. OREO is included in Level 3 of the valuation hierarchy due to the lack of observable market inputs into the determination of fair value. Appraisal values are property-specific and sensitive to the changes in the overall economic environment.

Liabilities

Other liabilities – Pinnacle Financial has certain liabilities carried at fair value including certain interest rate swap agreements to facilitate customer transactions. The fair value of these liabilities is based on Pinnacle Financial's pricing models that utilize observable market inputs and is reflected within Level 2 of the valuation hierarchy.

The following tables present financial instruments measured at fair value on a recurring basis as of June 30, 2016 and December 31, 2015, by caption on the consolidated balance sheets and by FASB ASC 820 valuation hierarchy (as described above) (in thousands):

| June 30, 2016 | Total carrying value in the consolidated balance sheet | Quoted market prices in an active market (Level 1) | Models with significant observable market parameters (Level 2) | Models with significant unobservable market parameters (Level 3) |
|---|---|---|---|---|
| Investment securities available-for-sale: | | | | |
| U.S. treasury securities | $ - | $ - | $ - | $ - |
| U.S. government agency securities | 96,447 | - | 96,447 | - |
| Mortgage-backed securities | 771,950 | - | 771,950 | - |
| State and municipal securities | 169,077 | - | 169,077 | - |
| Agency-backed securities | 67,344 | - | 67,344 | - |
| Corporate notes and other | 4,403 | - | 4,403 | - |
| Total investment securities available-for-sale | $ 1,109,221 | $ - | $ 1,109,221 | $ - |
| Other investments | 10,381 | - | - | 10,381 |
| Other assets | 36,893 | - | 36,893 | - |
| Total assets at fair value | $ 1,156,495 | $ - | $ 1,146,114 | $ 10,381 |
| | | | | |
| Other liabilities | $ 38,983 | $ - | $ 38,983 | $ - |
| Total liabilities at fair value | $ 38,983 | $ - | $ 38,983 | $ - |
| | | | | |
| December 31, 2015 | | | | |
| Investment securities available-for-sale: | | | | |
| U.S. treasury securities | $ - | $ - | $ - | $ - |
| U.S. government agency securities | 128,193 | - | 128,193 | - |
| Mortgage-backed securities | 582,916 | - | 582,916 | - |
| State and municipal securities | 165,042 | - | 165,042 | - |
| Agency-backed securities | 48,801 | - | 48,801 | - |
| Corporate notes and other | 10,113 | - | 10,113 | - |
| Total investment securities available-for-sale | 935,065 | - | 935,065 | - |
| Other investments | 9,764 | - | - | 9,764 |
| Other assets | 15,147 | - | 15,147 | - |
| Total assets at fair value | $ 959,976 | $ - | $ 950,212 | $ 9,764 |
| | | | | |
| Other liabilities | $ 16,568 | $ - | $ 16,568 | $ - |
| Total liabilities at fair value | $ 16,568 | $ - | $ 16,568 | $ - |

The following table presents assets measured at fair value on a nonrecurring basis as of June 30, 2016 and December 31, 2015 (in thousands):

| June 30, 2016 | Total carrying value in the consolidated balance sheet | Quoted market prices in an active market (Level 1) | Models with significant observable market parameters (Level 2) | Models with significant unobservable market parameters (Level 3) | Total losses for the year-to-date period then ended |
|---|---|---|---|---|---|
| Other real estate owned | $ 5,006 | $ - | $ - | $ 5,006 | $ (219 ) |
| Collateral dependent nonaccrual loans, net | 26,752 | - | - | 26,752 | (2,804 ) |
| Total | $ 31,758 | $ - | $ - | $ 31,758 | $ (3,023 ) |
| | | | | | |
| December 31, 2015 | | | | | |
| Other real estate owned | $ 5,083 | $ - | $ - | $ 5,083 | $ (41 ) |
| Collateral dependent nonaccrual loans, net | 18,958 | - | - | 18,958 | (2,637 ) |
| Total | $ 24,041 | $ - | $ - | $ 24,041 | $ (2,678 ) |

In the case of the investment securities portfolio, Pinnacle Financial monitors the portfolio to ascertain when transfers between levels have been affected. The nature of the remaining assets and liabilities is such that transfers in and out of any level are expected to be rare. For the six months ended June 30, 2016, there were no transfers between Levels 1, 2 or 3.

The table below includes a rollforward of the balance sheet amounts for the six months ended June 30, 2016 (including the change in fair value) for financial instruments classified by Pinnacle Financial within Level 3 of the valuation hierarchy for assets and liabilities measured at fair value on a recurring basis. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, since Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources), the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology (in thousands):

| | For the six months ended June 30, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| | Other assets | Other liabilities | Other assets | Other liabilities |
| Fair value, January 1 | $9,764 | $ - | $8,004 | $ - |
| Total realized gains included in income | 336 | - | 173 | - |
| Change in unrealized gains/losses included in other comprehensive income for assets and liabilities still held at period end | - | - | - | - |
| Purchases | 571 | - | 548 | - |
| Issuances | - | - | - | - |
| Settlements | (290 ) | - | (563 ) | - |
| Transfers out of Level 3 | - | - | - | - |
| Fair value, June 30 | 10,381 | - | 8,162 | - |
| Total realized gains included in income related to financial assets and liabilities still on the consolidated balance sheet at June 30 | $336 | $ - | $173 | $ - |

The following methods and assumptions were used by Pinnacle Financial in estimating its fair value disclosures for financial instruments that are not measured at fair value. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow models. Those models are significantly affected by the assumptions used, including the discount rates, estimates of future cash flows and borrower creditworthiness. The fair value estimates presented herein are based on pertinent information available to management as of June 30, 2016 and December 31, 2015. Such amounts have not been revalued for purposes of these consolidated financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

Securities held-to-maturity - Estimated fair values for investment securities are based on quoted market prices where available. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics.

Loans, net - The fair value of our loan portfolio includes a credit risk factor in the determination of the fair value of our loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. Our loan portfolio is initially fair valued using a segmented approach. We divide our loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk.

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral. For other loans, fair values are estimated using discounted cash flow models, using current market interest rates offered for loans with similar terms to borrowers of similar credit quality. The values derived from the discounted cash flow approach for each of the above portfolios are then further discounted to incorporate credit risk to determine the exit price.

Mortgage loans held-for-sale - Mortgage loans held-for-sale are carried at the lower of cost or fair value. The estimate of fair value is based on pricing models and other information.

Deposits, securities sold under agreements to repurchase, Federal Home Loan Bank (FHLB) advances, subordinated debt and other borrowings - The carrying amounts of demand deposits, savings deposits, securities sold under agreements to repurchase, floating rate advances from the FHLB, floating rate subordinated debt and other borrowings, and floating rate loans approximate their fair values due to having no stated maturity. Fair values for certificates of deposit, fixed rate advances from the FHLB and fixed rate subordinated debt are estimated using discounted cash flow models, using current market interest rates offered on certificates, advances and other borrowings with similar remaining maturities. For fixed rate subordinated debt, the maturity is assumed to be as of the earliest date that the indebtedness will be repriced.

Off-balance sheet instruments - The fair values of Pinnacle Financial's off-balance-sheet financial instruments are based on fees charged to enter into similar agreements. However, commitments to extend credit do not represent a significant value to Pinnacle Financial until such commitments are funded.

The following table presents the carrying amounts, estimated fair value and placement in the fair value hierarchy of Pinnacle Financial's financial instruments at June 30, 2016 and December 31, 2015. This table excludes financial instruments for which the carrying amount approximates fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as non-interest bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity (in thousands).

| (in thousands)<br>June 30, 2016 | Carrying/ Notional Amount | Estimated Fair Value[(1)] | Quoted market prices in an active market (Level 1) | Models with significant observable market parameters (Level 2) | Models with significant unobservable market parameters (Level 3) |
|---|---|---|---|---|---|
| Financial assets: | | | | | |
| Securities held-to-maturity | $28,512 | $29,093 | $ - | $ 29,093 | $ - |
| Loans, net | 7,029,990 | 6,972,722 | - | - | 6,972,722 |
| Mortgage loans held-for-sale | 53,119 | 54,335 | - | 54,335 | - |
| Loans held-for-sale | 9,323 | 9,531 | - | 9,531 | - |
| Financial liabilities: | | | | | |
| Deposits and securities sold under agreements to repurchase | 7,366,143 | 7,054,670 | - | - | 7,054,670 |
| Federal Home Loan Bank advances | 783,240 | 783,733 | - | - | 783,733 |
| Subordinated debt and other borrowings | 229,714 | 211,594 | - | - | 211,594 |
| Off-balance sheet instruments: | | | | | |
| Commitments to extend credit [(2)] | 2,548,355 | 700 | - | - | 700 |
| Standby letters of credit [(3)] | 101,845 | 486 | - | - | 486 |
| December 31, 2015 | | | | | |
| Financial assets: | | | | | |
| Securities held-to-maturity | $31,377 | $31,586 | $ - | $ 31,586 | $ - |
| Loans, net | 6,477,803 | 6,379,153 | - | - | 6,379,153 |
| Mortgage loans held for sale | 47,930 | 48,365 | - | 48,365 | - |
| Financial liabilities: | | | | | |
| Deposits and securities sold under agreements to repurchase | 7,050,498 | 6,562,509 | - | - | 6,562,509 |
| Federal Home Loan Bank advances | 300,305 | 299,214 | - | - | 299,214 |
| Subordinated debt and other borrowings | 141,606 | 131,494 | - | - | 131,494 |
| Off-balance sheet instruments: | | | | | |
| Commitments to extend credit [(2)] | 2,218,784 | 1,017 | - | - | 1,017 |
| Standby letters of credit [(3)] | 93,534 | 354 | - | - | 354 |

(1) Estimated fair values are consistent with an exit-price concept. The assumptions used to estimate the fair values are intended to approximate those that a market-participant would realize in a hypothetical orderly transaction.

(2) At the end of each quarter, Pinnacle Financial evaluates the inherent risks of the outstanding off-balance sheet commitments. In making this evaluation, Pinnacle Financial evaluates the credit worthiness of the borrower, the collateral supporting the commitments and any other factors similar to those used to evaluate the inherent risks of our loan portfolio. Additionally, Pinnacle Financial evaluates the probability that the outstanding commitment will eventually become a funded loan. As a result, at June 30, 2016 and December 31, 2015, Pinnacle Financial included in other liabilities $700,000 and $1.0 million, respectively, representing the inherent risks associated with these off-balance sheet commitments.

(3) At June 30, 2016 and December 31, 2015, the fair value of Pinnacle Financial's standby letters of credit was $486,000 and $354,000, respectively. This amount represents the unamortized fee associated with these standby letters of credit and is included in the consolidated balance sheet of Pinnacle Financial and is believed to approximate fair value. This fair value will decrease over time as the existing standby letters of credit approach their expiration dates.

Note 12. Other borrowings

On March 10, 2016, Pinnacle Bank completed the issuance of an additional $70.0 million aggregate principal amount of its 4.875% Fixed-to-Floating Rate Subordinated Notes due 2025 (the Notes) in a private placement transaction to accredited institutional investors. The Notes were priced at 99.023% of the principal amount per note, for an effective interest rate of 5.125%. The maturity date of the Notes is July 30, 2025, although Pinnacle Bank may redeem some or all of the Notes beginning on the interest payment date of July 30, 2020 and on any interest payment date thereafter at a redemption price equal to 100% of the principal amount of the Notes to be redeemed plus accrued and unpaid interest to the date of redemption, subject to the prior approval of the Federal Deposit Insurance Corporation (the FDIC).

From the date of the issuance through July 29, 2020, the Notes will bear interest at the rate of 4.875% per year and will be payable semi-annually in arrears on January 30 and July 30 of each year, beginning on January 30, 2016. From July 30, 2020, the Notes will bear interest at a rate per annum equal to the three-month LIBOR rate plus 3.128%, payable quarterly in arrears on each January 30, April 30, July 30, and October 30, beginning on July 30, 2020, through the maturity date or the early redemption date of the Notes.

The sale of the Notes yielded net proceeds of approximately $68.3 million after deducting the placement agents' fees and estimated expenses payable by Pinnacle Bank. Pinnacle Bank used the net proceeds from the offering for general corporate purposes (including the repayment of short term borrowings of Pinnacle Bank used to pay a portion of the cash portion of the purchase price for the additional equity interests of BHG acquired by Pinnacle Bank on March 1, 2016).

The subordinated debt evidenced by the Notes is recorded net of associated financing fees in accordance with ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs and totals $127.4 million as of June 30, 2016, compared to $59.0 million at December 31, 2015, net of associated debt issuance costs.

On March 29, 2016, Pinnacle Financial entered into a revolving credit agreement with a bank for borrowings of up to $75 million (the Loan Agreement). Borrowings under the revolving credit facility are anticipated to be used to fund the cash portion of the purchase price and the transaction costs associated with acquisitions made by Pinnacle Financial from time to time and for general corporate purposes including to fund capital contributions to Pinnacle Bank. Pinnacle Financial's borrowings under the Loan Agreement bear interest at a rate equal to 2.25% plus the greater of (i) zero percent (0%) or (ii) the one-month LIBOR rate quoted by the lender. The Loan Agreement also requires Pinnacle Financial to pay a quarterly fee beginning June 30, 2016 equal to 0.35% per annum on the average daily unused amount of available borrowings. As of June 30, 2016, there were $19.8 million of borrowings under the Loan Agreement, net of associated debt issuance costs, which were utilized to fund a capital contribution to Pinnacle Bank. An additional $10.0 million was drawn on July 1, 2016 to fund a portion of the cash portion of the merger consideration payable to Avenue's shareholders.

Upon consummation of the Avenue Merger, Pinnacle Financial assumed Avenue's obligations under its outstanding $20.0 million subordinated notes issued on December 29, 2014 (Avenue Subordinated Notes). The Avenue Subordinated Notes mature on December 29, 2024 and bear interest at a rate of 6.75% per annum until January 1, 2020. Beginning on January 1, 2020, the Avenue Subordinated 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%. Interest on the Avenue Subordinated Notes is payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, through December 29, 2024 or the earlier date of redemption of all of the Avenue Subordinated Notes. These notes will be recorded at fair value as of the acquisition date.

The Avenue Subordinated Notes will be redeemable by Pinnacle Financial, in whole or in part, on or after January 1, 2020 or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. The Avenue Subordinated Notes are not subject to redemption at the option of the holders.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition at June 30, 2016 and December 31, 2015 and our results of operations for the three and six months ended June 30, 2016 and 2015. The purpose of this discussion is to focus on information about our financial condition and results of operations which is not otherwise apparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes included elsewhere herein.

Overview

Our diluted net income per common share for the three and six months ended June 30, 2016 was $0.73 and $1.42, respectively, compared to $0.64 and $1.25 for the three and six months ended June 30, 2015, respectively. At June 30, 2016, loans had increased to $7.091 billion, as compared to $6.543 billion at December 31, 2015, and total deposits increased to $7.293 billion at June 30, 2016 from $6.971 billion at December 31, 2015.

We acquired a 30% membership interest in Bankers Healthcare Group, LLC (BHG) on February 1, 2015 for $75.0 million and acquired an additional 19% membership interest in BHG on March 1, 2016 for $74.1 million in cash and 860,470 shares of common stock, with a fair value of $39.9 million on the date of the acquisition. We acquired CapitalMark Bank and Trust (CapitalMark) on July 31, 2015 and Magna Bank (Magna) on September 1, 2015. At the acquisition date, CapitalMark had net assets of $73.2 million, including loans of $857.5 million and deposits valued at $953.2 million. At the acquisition date, Magna had net assets of $50.5 million, including loans of $442.3 million and deposits valued at $452.7 million. These acquisitions further expanded our footprint into East and West Tennessee.

During the first quarter of 2016, we announced that we had signed a definitive agreement for Avenue Financial Holdings, Inc. (Avenue) to merge with us. The merger was consummated on July 1, 2016. Each holder of Avenue common stock (including restricted shares) received 0.36 shares of Pinnacle Financial's common stock plus $2.00 per share in cash for each share of Avenue common stock held by each shareholder on the closing date. This acquisition increases our market share in the Nashville MSA. At the closing of the merger, Avenue had 10,445,349 shares of common stock issued and outstanding (including shares of restricted stock whose restrictions lapsed upon acquisition) and 101,389 outstanding unexercised stock options. We issued approximately 3.76 million shares of our common stock and paid cash consideration of approximately $20.9 million (including payments related to fractional shares) to the Avenue shareholders and approximately $1.0 million to holders of unexercised options to purchase shares of Avenue common stock. As of June 30, 2016, Avenue had total assets of $1.225 billion, $982.8 million in loans and $965.3 million in deposits.

Results of Operations. Our net interest income increased $23.2 million to $75.0 million for the second quarter of 2016 compared to $51.8 million for the second quarter of 2015. Our net interest income increased $45.8 million to $148.9 million for the six months ended June 30, 2016 compared to $103.1 million in the same period in 2015. The net interest margin (the ratio of net interest income to average earning assets) for the three and six months ended June 30, 2016 was 3.72% and 3.75%, respectively, compared to 3.65% and 3.71% for the same periods in 2015, respectively.

Our provision for loan losses was $5.3 million and $9.2 million for the three and six months ended June 30, 2016 compared to $1.2 million and $1.5 million for the same periods in 2015. Provision expense for the three and six month periods when compared to the comparable periods in 2015 was impacted by increased charge-offs realized in our consumer portfolio, primarily related to automobile loans. Net charge-offs were $6.1 million and $13.2 million for the three and six months ended June 30, 2016, compared to $1.9 million and $3.3 million for the same periods in 2015.

Our allowance for loan losses as a percentage of total loans decreased from 1.00% at December 31, 2015 to 0.87% at June 30, 2016. Management believes the decrease in the allowance for loan losses as a percentage of total loans was supported by the credit quality in our loan portfolio despite increasing charge-offs related to automobile financing, which represents a small portion of the total portfolio. The overall methodology used to estimate the allowance for loan losses is consistent with the quarter ended March 31, 2016. For purchased loans (including those acquired in connection with our recent mergers that have been consummated), the allowance for loan losses subsequent to the acquisition date is consistent with that utilized for legacy Pinnacle Financial loans. Our accounting policy is to compare the computed allowance for loan losses on purchased loans to the remaining fair value adjustment at the individual loan level. If the computed allowance is greater than the remaining fair value adjustment, the excess is added to the allowance for loan losses by a provision for loan losses.

Noninterest income increased by $12.7 million and $20.1 million during the three and six months ended June 30, 2016, compared to the same periods in 2015. Income from equity method investment was $9.6 million and $14.8 million for the three and six months ended June 30, 2016 compared to $4.3 million and $7.5 million in the same prior year periods. As discussed above, we increased our investment in BHG from 30% to 49% on March 1, 2016, which impacted the comparable periods. Gains on mortgage loans sold increased $2.6 million and $4.2 million, respectively, over the same periods in the prior year due to continued strength in the local housing economy in many of our markets. The remaining growth in noninterest income was primarily attributable to increased interchange revenues as well as increased production in our fee-based products such as investments, insurance and trust.

Noninterest expense increased by $19.2 million and $36.4 million during the three and six months ended June 30, 2016, as compared to the three and six months ended June 30, 2015, primarily as a result of increased salaries and employment benefits resulting from annual merit increases awarded in the first quarter of 2016, new hires resulting from our acquisitions of CapitalMark and Magna and the overall increase in our associate base. Our associate base has expanded from 800.5 full-time equivalent employees at June 30, 2015 to 1,061.0 full-time equivalent employees at June 30, 2016, due to both opportunistic hires and our acquisitions of CapitalMark and Magna.

During the three and six months ended June 30, 2016, we recorded income tax expense of $15.8 million and $29.6 million, respectively. Pinnacle Financial's effective tax rate for the six months ended June 30, 2016 and 2015 of 33.5% and 33.1%, respectively, differs from the combined federal and state income tax statutory rate primarily due to investments in bank qualified municipal securities, our real estate investment trust, participation in the Community Investment Tax Credit program and bank-owned life insurance offset in part by limited deductibility of meals and entertainment expense.

Our efficiency ratio (the ratio of noninterest expense to the sum of net interest income and noninterest income) was 51.9% and 53.0% for the three and six months ended June 30, 2016, compared to 51.1% and 52.0% for the same periods in 2015. Net income for the three and six months ended June 30, 2016 was $30.8 million and $58.8 million, respectively, compared to $22.7 million and $44.5 million for the same periods in 2015.

Financial Condition. Net loans increased $552.2 million, or 8.5%, during the six months ended June 30, 2016, of which $169.2 million were purchased from a bank in the Memphis MSA. Total deposits were $7.293 billion at June 30, 2016, compared to $6.971 billion at December 31, 2015, an increase of $321.4 million. At June 30, 2016, our capital ratios, including our bank's capital ratios, exceeded those levels necessary to be considered well-capitalized under applicable regulatory guidelines.

From time to time we may be required to support the capital needs of Pinnacle Bank. At June 30, 2016, we had approximately $31.8 million of cash at the holding company substantially all of which could be used to support our bank. During the first quarter of 2016, we established a revolving line of credit with another bank that can be utilized to provide additional capital support to Pinnacle Bank.

Critical Accounting Estimates

The accounting principles we follow and our methods of applying these principles conform with U.S. GAAP and with general practices within the banking industry. There have been no significant changes to our Critical Accounting Policies as described in our Annual Report on Form 10-K for the year ended December 31, 2015.

Results of Operations

The following is a summary of our results of operations (dollars in thousands, except per share data):

| | Three months ended June 30, 2016 | 2015 | 2016 - 2015 Percent Increase | | Six months ended June 30, 2016 | 2015 | 2016-2015 Percent Increase | |
|---|---|---|---|---|---|---|---|---|
| Interest income | $83,762 | $55,503 | 50.9 | % | $164,736 | $110,181 | 49.5 | % |
| Interest expense | 8,718 | 3,672 | 137.4 | % | 15,790 | 7,082 | 123.0 | % |
| Net interest income | 75,044 | 51,831 | 44.8 | % | 148,946 | 103,099 | 44.5 | % |
| Provision for loan losses | 5,280 | 1,186 | 345.2 | % | 9,174 | 1,501 | 511.1 | % |
| Net interest income after provision for loan losses | 69,764 | 50,645 | 37.8 | % | 139,772 | 101,598 | 37.6 | % |
| Noninterest income | 32,713 | 20,019 | 63.4 | % | 58,569 | 38,512 | 52.1 | % |
| Noninterest expense | 55,931 | 36,747 | 52.2 | % | 109,994 | 73,578 | 49.5 | % |
| Net income before income taxes | 46,546 | 33,916 | 37.2 | % | 88,346 | 66,532 | 32.8 | % |
| Income tax expense | 15,759 | 11,252 | 40.0 | % | 29,594 | 22,025 | 34.4 | % |
| Net income | $30,787 | $22,664 | 35.8 | % | $58,752 | $44,507 | 32.0 | % |
| | | - | | | - | - | | |
| Basic net income per common share | $$0.75 | $$0.65 | 15.4 | % | $$1.44 | $$1.27 | 13.4 | % |
| Diluted net income per common share | $$0.73 | $$0.64 | 14.1 | % | $$1.42 | $$1.25 | 13.6 | % |

Net Interest Income. Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest-bearing liabilities and is the most significant component of our revenues. Net interest income totaled $75.0 million and $148.9 million for the three and six months ended June 30, 2016, an increase of $23.2 million and $45.8 million, from the levels recorded in the same periods of 2015. We were able to increase net interest income during the six months ended June 30, 2016 compared to the same period in 2015 due primarily to our focus on growing our loan portfolio both organically and by acquisition. Average loans for the six months ended June 30, 2016 were 46.8% greater than average balances for the same period in 2015.

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The following tables set forth the amount of our average balances, interest income or interest expense for each category of interest-earning assets and interest-bearing liabilities and the average interest rate for interest-earning assets and interest-bearing liabilities, net interest spread and net interest margin for the three and six months ended June 30, 2016 and 2015 (dollars in thousands):

| | Three Months Ended June 30, 2016 | | | | Three Months Ended June 30, 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Average Balances | Interest | Rates/ Yields | | Average Balances | Interest | Rates/ Yields | |
| Interest-earning assets: | | | | | | | | |
| Loans [1,2] | $6,997,592 | $77,043 | 4.53 | % | $4,736,818 | $50,326 | 4.27 | % |
| Securities: | | | | | | | | |
| Taxable | 880,976 | 4,572 | 2.09 | % | 681,829 | 3,460 | 2.04 | % |
| Tax-exempt [2] | 183,084 | 1,443 | 4.25 | % | 154,596 | 1,400 | 4.86 | % |
| Federal funds sold and other | 301,005 | 704 | 0.94 | % | 191,271 | 316 | 0.66 | % |
| Total interest-earning assets | 8,362,657 | $83,762 | 4.06 | % | 5,764,514 | $55,502 | 3.91 | % |
| Nonearning assets | | | | | | | | |
| Intangible assets | 440,504 | | | | 245,964 | | | |
| Other nonearning assets | 502,780 | | | | 309,234 | | | |
| Total assets | $9,305,941 | | | | $6,319,712 | | | |
| | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | |
| Interest-bearing deposits: | | | | | | | | |
| Interest checking | $1,352,898 | $904 | 0.27 | % | $1,074,853 | $532 | 0.20 | % |
| Savings and money market | 3,085,734 | 3,019 | 0.39 | % | 1,951,863 | 1,488 | 0.31 | % |
| Time | 651,194 | 1,151 | 0.71 | % | 420,514 | 572 | 0.55 | % |
| Total interest-bearing deposits | 5,089,826 | 5,074 | 0.40 | % | 3,447,230 | 2,592 | 0.30 | % |
| Securities sold under agreements to repurchase | 65,121 | 40 | 0.24 | % | 61,355 | 29 | 0.19 | % |
| Federal Home Loan Bank advances | 653,750 | 1,256 | 0.77 | % | 388,963 | 224 | 0.23 | % |
| Subordinated debt and other borrowings | 225,240 | 2,348 | 4.19 | % | 135,884 | 826 | 2.44 | % |
| Total interest-bearing liabilities | 6,033,937 | 8,718 | 0.58 | % | 4,033,432 | 3,671 | 0.37 | % |
| Noninterest-bearing deposits | 2,003,523 | - | - | | 1,437,276 | - | - | |
| Total deposits and interest-bearing liabilities | 8,037,460 | $8,718 | 0.44 | % | 5,470,708 | $3,671 | 0.27 | % |
| Other liabilities | 20,719 | | | | 12,213 | | | |
| Stockholders' equity | 1,247,762 | | | | 836,791 | | | |
| Total liabilities and stockholders' equity | $9,305,941 | | | | $6,319,712 | | | |
| Net interest income | | $75,044 | | | | $51,831 | | |
| Net interest spread [3] | | | 3.48 | % | | | 3.54 | % |
| Net interest margin [4] | | | 3.72 | % | | | 3.65 | % |

1. Average balances of nonaccrual loans are included in the above amounts.
2. Yields based on the carrying value of those tax exempt instruments are shown on a fully tax equivalent basis.
3. Yields realized on interest-bearing assets less the rates paid on interest-bearing liabilities. The net interest spread calculation excludes the impact of demand deposits. Had the impact of demand deposits been included, the net interest spread for the three months ended June 30, 2016 would have been 3.62% compared to a net interest spread of 3.64% for the three months ended June 30, 2015.
4. Net interest margin is the result of annualized net interest income calculated on a tax-equivalent basis divided by average interest-earning assets for the period.

| | Six Months Ended June 30, 2016 Average Balances | Interest | Rates/ Yields | Six Months Ended June 30, 2015 Average Balances | Interest | Rates/ Yields |
|---|---|---|---|---|---|---|
| Interest-earning assets: | | | | | | |
| Loans [1,2] | $6,869,823 | $151,447 | 4.51 % | $4,681,194 | $99,792 | 4.31 % |
| Securities: | | | | | | |
| Taxable | 845,945 | 9,039 | 2.15 % | 654,011 | 6,905 | 2.13 % |
| Tax-exempt [2] | 182,923 | 2,937 | 4.33 % | 158,609 | 2,884 | 4.90 % |
| Federal funds sold and other | 291,782 | 1,313 | 0.91 % | 179,703 | 601 | 0.67 % |
| Total interest-earning assets | 8,190,473 | $164,736 | 4.08 % | 5,673,517 | $110,182 | 3.96 % |
| Nonearning assets | | | | | | |
| Intangible assets | 440,485 | | | 246,138 | | |
| Other nonearning assets | 447,996 | | | 292,065 | | |
| Total assets | $9,078,954 | | | $6,211,720 | | |
| | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Interest checking | $1,378,931 | $1,835 | 0.27 % | $1,052,405 | $1,005 | 0.19 % |
| Savings and money market | 3,041,660 | 5,972 | 0.39 % | 1,973,818 | 2,898 | 0.30 % |
| Time | 662,788 | 2,182 | 0.66 % | 422,057 | 1,121 | 0.54 % |
| Total interest-bearing deposits | 5,083,379 | 9,989 | 0.40 % | 3,448,280 | 5,024 | 0.29 % |
| Securities sold under agreements to repurchase | 67,125 | 88 | 0.26 % | 63,916 | 60 | 0.19 % |
| Federal Home Loan Bank advances | 518,440 | 1,792 | 0.70 % | 339,763 | 444 | 0.26 % |
| Subordinated debt and other borrowings | 193,904 | 3,921 | 4.07 % | 128,499 | 1,555 | 2.44 % |
| Total interest-bearing liabilities | 5,862,848 | 15,790 | 0.54 % | 3,980,458 | 7,083 | 0.36 % |
| Noninterest-bearing deposits | 1,981,803 | - | - | 1,390,201 | - | - |
| Total deposits and interest-bearing liabilities | 7,844,651 | $15,790 | 0.40 % | 5,370,659 | $7,083 | 0.27 % |
| Other liabilities | 16,346 | | | 14,754 | | |
| Stockholders' equity | 1,217,957 | | | 826,307 | | |
| Total liabilities and stockholders' equity | $9,078,954 | | | $6,211,720 | | |
| Net interest income | | $148,946 | | | $103,099 | |
| Net interest spread [3] | | | 3.53 % | | | 3.60 % |
| Net interest margin [4] | | | 3.75 % | | | 3.71 % |

1. Average balances of nonaccrual loans are included in the above amounts.
2. Yields based on the carrying value of those tax exempt instruments are shown on a fully tax equivalent basis.
3. Yields realized on interest-bearing assets less the rates paid on interest-bearing liabilities. The net interest spread calculation excludes the impact of demand deposits. Had the impact of demand deposits been included, the net interest spread for the six months ended June 30, 2016 would have been 3.67% compared to a net interest spread of 3.70% for the six months ended June 30, 2015.
4. Net interest margin is the result of annualized net interest income calculated on a tax-equivalent basis divided by average interest-earning assets for the period.

For the three months ended June 30, 2016 and 2015, our net interest margin was 3.72% and 3.65%, respectively. For the six months ended June 30, 2016 and 2015, our net interest margin was 3.75% and 3.71% , respectively. In the fourth quarter of 2015, we experienced an increase in the Fed Funds rate, which, including the impact to other short-term notes, contributed to increased loan yields in the first and second quarters of 2016 with minimal impact to deposit costs. The net interest margin for the three and six months ended June 30, 2016 was also favorably impacted by the accretion of the fair value adjustment recorded on the recently acquired loan and deposit portfolios. We expect the net interest margin to decrease in future periods as the accretion amounts from the CapitalMark and Magna mergers continue to become less impactful in future periods. We also expect that we will incur increased funding costs as a result of competition for deposits in our markets. Additionally, loan pricing for creditworthy borrowers is very competitive in our markets and has continued to limit our ability to increase pricing on new and renewed loans over the last several quarters. We anticipate that this challenging competitive environment will continue throughout the remainder of 2016.

We continue to believe our net interest income should increase throughout the remainder of 2016 compared to 2015 due to an increase in average earning asset volumes, primarily loans, as a result of organic loan growth and our acquisition of Avenue. We anticipate funding these increased earning assets primarily by growing our core deposits, and utilizing limited wholesale funding to fund the shortfall, if any, resulting from loan growth outpacing deposit growth.

Provision for Loan Losses. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, should be adequate to provide coverage for the inherent losses on outstanding loans. Based upon management's assessment of the loan portfolio, we adjust our allowance for loan losses to an amount we believe is appropriate to adequately cover probable losses inherent in the loan portfolio. Our allowance for loan losses as a percentage of total loans decreased from 1.00% at December 31, 2015 to 0.87% at June 30, 2016, primarily as a result of the credit quality in our loan portfolio despite elevated charge-offs related to automobile financing, which represents a small portion of the total portfolio.

Based upon our evaluation of the loan portfolio, we believe the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at June 30, 2016. While our policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to operations, are considered adequate by management, they are necessarily approximate and imprecise. There are factors beyond our control, such as conditions in the local and national economy, local real estate markets, or particular industry or borrower-specific conditions, which may materially negatively impact our asset quality and the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

The provision for loan losses amounted to $5.3 million and $9.2 million for the three and six months ended June 30, 2016 compared to $1.2 million and $1.5 million for the three and six months ended June 30, 2015. Provision expense is impacted by the absolute level of loans, loan growth, the credit quality of the loan portfolio and the amount of net charge-offs. Provision expense increased in the three and six months ended June 30, 2016 compared to the three and six months ended June 30, 2015 due to increased charge-offs realized in our consumer portfolio, primarily related to automobile loans.

Noninterest Income. Our noninterest income is composed of several components, some of which vary significantly between quarterly and annual periods. Service charges on deposit accounts and other noninterest income generally reflect customer growth trends, while fees from our wealth management departments, the origination of mortgage loans, income from our equity method investment and gains and losses on the sale of securities will often reflect market conditions and fluctuate from period to period.

The following is a summary of our noninterest income for the three and six months ended June 30, 2016 and 2015 (dollars in thousands):

| | Three months ended June 30, | | 2016-2015 Percent Increase (Decrease) | | Six months ended June 30, | | 2016-2015 Percent Increase (Decrease) | |
|---|---|---|---|---|---|---|---|---|
| | 2016 | 2015 | | | 2016 | 2015 | | |
| Noninterest income: | | | | | | | | |
| Service charges on deposit accounts | $3,430 | $3,076 | 11.5 | % | $6,873 | $5,988 | 14.8 | % |
| Investment services | 2,500 | 2,399 | 4.2 | % | 4,845 | 4,658 | 4.0 | % |
| Insurance sales commissions | 1,193 | 1,106 | 7.9 | % | 2,899 | 2,618 | 10.7 | % |
| Gains on mortgage loans sold, net | 4,221 | 1,652 | 155.5 | % | 7,789 | 3,593 | 116.8 | % |
| Gain on sale of investment securities, net | - | 556 | (100.0 | %) | - | 562 | (100.0 | %) |
| Trust fees | 1,492 | 1,230 | 21.3 | % | 3,073 | 2,542 | 20.9 | % |
| Income from equity method investment | 9,644 | 4,266 | 126.1 | % | 14,792 | 7,467 | 98.1 | % |
| Other noninterest income: | | | | | | | | |
| Interchange and other consumer fees | 5,768 | 3,893 | 48.2 | % | 11,587 | 7,692 | 50.6 | % |
| Bank-owned life insurance | 878 | 573 | 53.2 | % | 1,641 | 1,173 | 39.9 | % |
| Loan swap fees | 1,780 | 611 | 191.3 | % | 2,511 | 1,093 | 129.7 | % |
| Other noninterest income | 1,807 | 657 | 174.9 | % | 2,559 | 1,126 | 127.3 | % |
| Total other noninterest income | 10,233 | 5,734 | 78.5 | % | 18,298 | 11,084 | 65.1 | % |
| Total noninterest income | $32,713 | $20,019 | 63.4 | % | $58,569 | 38,512 | 52.1 | % |

The increase in service charges on deposit accounts in the three and six months ended June 30, 2016 compared to the three and six months ended June 30, 2015 is primarily related to increased analysis fees due to an increase in the volume and number of commercial checking accounts, related to both organic and merger-related growth.

Income from our wealth management groups (investments, insurance and trust) is also included in noninterest income. For the three and six months ended June 30, 2016, commissions and fees from investment services at our financial advisory unit, Pinnacle Asset Management, a division of Pinnacle Bank, increased by $101,000 and $187,000 as compared to the three and six months ended June 30, 2015. At June 30, 2016, Pinnacle Asset Management was receiving commissions and fees in connection with approximately $2.0 billion in brokerage assets held with Raymond James Financial Services, Inc, compared to $1.8 billion at June 30, 2015. Revenues from the sale of insurance products by our insurance subsidiary for the three and six months ended June 30, 2016 were approximately $1.2 million and $2.9 million, respectively, compared to $1.1 million and $2.6 million for the three and six months ended June 30, 2015. Included in insurance revenues for the six months ended June 30, 2016 was $474,000 of contingent income received based on 2015 sales production compared to $403,000 recorded in the same period in the prior year. Additionally, at June 30, 2016, our trust department was receiving fees on approximately $953.6 million of managed assets compared to $924.6 million at June 30, 2015. Trust fees for the six months ended June 30, 2016 increased by 20.9% when compared to the same period in 2015.

Gains on mortgage loans sold, net, consists of fees from the origination and sale of mortgage loans. These mortgage fees are for loans originated in our current markets that are subsequently sold to third-party investors. Substantially all of these loan sales transfer servicing rights to the buyer. Generally, mortgage origination fees increase in lower interest rate environments and more robust housing markets and decrease in rising interest rate environments and more challenging housing markets. Mortgage origination fees will fluctuate from quarter to quarter as the rate environment changes. Gains on mortgage loans sold, net, were $4.2 million and $7.8 million, respectively, for the three and six months ended June 30, 2016 as compared to $1.7 million and $3.6 million, respectively, for the same periods in the prior year. The increase between the two periods is attributable to the strong economy in our markets as well as additional personnel in our production unit at June 30, 2016 compared to June 30, 2015.

Income from equity-method investment is comprised of income from our equity-method investment in BHG, which was entered into during the first quarter of 2015 and was increased from 30% to 49% on March 1, 2016. Income from equity-method investment was $9.6 million and $14.8 million for the three and six months ended June 30, 2016 compared to $4.3 million and $7.5 million for the same periods in the prior year. Income from our equity-method investment is reported net of amortization and accretion of fair value adjustments recorded as of the acquisition date. Amortization expense of $575,000 and $953,000 was included for the three and six months ended June 30, 2016 compared to $600,000 and $1.0 million for the same periods in the prior year. The income associated with this equity-method investment may fluctuate from period to period.

Included in other noninterest income are interchange and other consumer fees, gains from bank-owned life insurance, swap fees earned for the facilitation of derivative transactions for our clients, changes in the fair value of our other equity investments and other items. Interchange revenues increased as a result of the number of cards being used throughout our expanded client network as compared to the comparable periods in 2015. Other noninterest income included changes in the cash surrender value of bank-owned life insurance which was $878,000 and $1.6 million for the three and six months ended June 30, 2016 compared to $573,000 and $1.2 million for the three and six months ended June 30, 2015. Also during the second quarter of 2016, Pinnacle received a settlement on a bank-owned life insurance policy reducing the asset balance by $969,000 and recorded a realized gain of $461,000 included in other income. The assets that support these policies are administered by the life insurance carriers and the income we receive (i.e., increases or decreases in the cash surrender value of the policies) on these policies is dependent upon the returns the insurance carriers are able to earn on the underlying investments that support the policies. Earnings on these policies generally are not taxable. Loan swap fees are also included in other noninterest income and increased by $1.2 million and $1.4 million when compared to the three and six months ended June 30, 2015 as a result of increase in market demand in the current rate environment.

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 in conjunction with a decision to exit the residential servicing line of business, Pinnacle Bank sold the mortgage servicing rights associated with the $830 million Fannie Mae portion of the residential servicing portfolio for $6.6 million, net of associated costs to sell. Approximately $241,000 was recorded as income in the first quarter of 2016 as a result of the sale.

Noninterest Expense. Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, other real estate expenses, and other operating expenses. The following is a summary of our noninterest expense for the three and six months ended June 30, 2016 and 2015 (in thousands):

| | Three months ended June 30, 2016 | 2015 | 2016-2015 Percent Increase | | Six months ended June 30, 2016 | 2015 | 2016-2015 Percent Increase | |
|---|---|---|---|---|---|---|---|---|
| Noninterest expense: | | | | | | | | |
| Salaries and employee benefits: | | | | | | | | |
| Salaries | $19,393 | $13,468 | 44.0 | % | $38,598 | $26,292 | 46.8 | % |
| Commissions | 1,487 | 1,383 | 7.5 | % | 2,919 | 2,771 | 5.3 | % |
| Cash and equity incentives | 7,916 | 5,308 | 49.1 | % | 13,764 | 10,787 | 27.6 | % |
| Employee benefits and other | 5,458 | 3,616 | 50.9 | % | 11,490 | 7,455 | 54.1 | % |
| Total salaries and employee benefits | 34,254 | 23,775 | 44.1 | % | 66,771 | 47,305 | 41.1 | % |
| Equipment and occupancy | 8,312 | 5,878 | 41.4 | % | 16,442 | 11,924 | 37.9 | % |
| Other real estate expense (benefit), net | 222 | (115 ) | 294.2 | % | 335 | 281 | 19.2 | % |
| Marketing and business development | 1,538 | 1,186 | 29.6 | % | 2,801 | 2,146 | 30.5 | % |
| Postage and supplies | 1,050 | 731 | 43.6 | % | 2,007 | 1,380 | 45.4 | % |
| Amortization of intangibles | 847 | 227 | 272.3 | % | 1,720 | 455 | 278.1 | % |
| Merger related expense | 980 | 59 | *NM* | | 2,810 | 59 | *NM* | |
| Other noninterest expense | 8,728 | 5,006 | 74.4 | % | 17,108 | 10,028 | 70.6 | % |
| Total noninterest expense | $55,931 | 36,747 | 52.2 | % | $109,994 | $73,578 | 49.5 | % |

Total salaries and employee benefits expenses increased approximately $19.5 million for the first six months of 2016 over the same period in 2015. The increase in salaries is the result of our annual merit increases being effective January 1 as well as the overall increase in our associate base. At June 30, 2016, our associate base had expanded to 1,061.0 full-time equivalent associates as compared to 800.5 at June 30, 2015 resulting from both organic and merger-related growth. We expect salary expenses will continue to rise as we hire more experienced bankers throughout our expanded footprint and add the Avenue employees that we will retain following the closing of that acquisition. Moreover, since the acquisition of Avenue results in our exceeding $10 billion in total assets triggering certain provisions of the Dodd-Frank Act, we also expect our compliance costs, FDIC insurance assessment expense and salaries and benefits costs to increase.

We believe that cash and equity incentives are a valuable tool in motivating an employee base that is focused on providing our clients effective financial advice and increasing shareholder value. As a result, and unlike many other financial institutions, all of our non-commissioned associates participate in our annual cash incentive plan and all of our associates participate in our equity compensation plans. Under the annual cash incentive plan, the targeted level of incentive payments requires achievement of a certain soundness threshold, a revenue component and a targeted level of earnings (subject to certain adjustments). To the extent that the soundness threshold is met and revenues and earnings are above or below the targeted amount, the aggregate incentive payments are increased or decreased. Historically, we have paid between 0% and 125% of our targeted incentives. We currently believe based on our performance through the end of the second quarter of 2016, our performance for fiscal 2016 will achieve our targeted level of earnings, therefore we are currently accruing incentive costs for the cash incentive plan in 2016 at 100% of targeted awards.

Under our equity incentive plans, we provide a broad-based equity incentive program for all associates utilizing restricted share awards and, for certain of our associates, performance unit awards. We believe that equity incentives provide a vehicle for all associates to become meaningful stockholders of Pinnacle Financial over an extended period of time and create a stockholder-centric culture throughout our organization. We expect that compensation expense associated with equity awards for the remainder of 2016 will continue to increase when compared to comparable periods in 2015 as a result of the additional associates we have already hired in 2016 and our intention to hire additional experienced financial advisors throughout the remainder of 2016.

Equipment and occupancy expenses for the three and six months ended June 30, 2016, increased $2.4 million and $4.5 million, respectively, as compared to the same periods in the prior year primarily due to our acquisitions of CapitalMark and Magna. An additional location will be open or under construction in each of our markets before the end of 2016. We expect to supplement our retail network with the construction of a new retail office in the Chattanooga, Knoxville and Memphis markets each year for the next few years. In future periods, these expansions and our acquisition of Avenue may lead to higher equipment and occupancy expenses as well as related increases in salaries and benefits expense.

At June 30, 2016, we had $5.0 million in OREO assets compared to $5.1 million at December 31, 2015. We recognized other real estate expense of $222,000 and $335,000 for the three and six months ended June 30, 2016, respectively, compared to a benefit of $115,000 and an expense of $281,000 for the same periods in the prior year. Other real estate expense includes realized gains and losses on dispositions and holding losses due to reduced valuations of OREO properties as well as carrying costs to maintain or improve the properties.

Intangible amortization expense was $847,000 and $1.7 million for the three and six months ended June 30, 2016 compared to $227,000 and $455,000 for the same periods in 2015. The following table outlines our amortizing intangible assets, their initial valuation and amortizable lives:

| | Year Acquired | Initial Valuation (in millions) | Amortizable Life (in years) |
|---|---|---|---|
| Core Deposit Intangible: | | | |
| Mid-America | 2007 | $ 9.5 | 10 |
| CapitalMark | 2015 | 6.2 | 7 |
| Magna | 2015 | 3.2 | 6 |
| Book of Business Intangibles: | | | |
| Miller Loughry Beach | 2008 | 1.3 | 20 |
| CapitalMark Trust Department | 2015 | 0.3 | 16 |

These assets are being amortized on an accelerated basis which reflects the anticipated life of the underlying assets. Amortization expense is estimated to approximate between $740,000 and $3.2 million per year for each of the next five years with lesser amounts for the remaining amortization period (excluding any additional amortization expense resulting from our July 1, 2016 acquisition of Avenue). Intangible amortization expense will increase in future periods as a result of our merger with Avenue.

During the three and six months ended June 30, 2016, merger related charges of $980,000 and $2.8 million were incurred associated with our acquisitions. We will continue to incur merger related charges as we complete the operational integration of Avenue, which we currently expect to be in September 2016.

Total other noninterest expenses increased by $3.7 million and $7.1 million during the three and six months ended June 30, 2016 when compared to the same periods in 2015. The increase is attributable to a variety of factors including increased collections expense attributable to our consumer auto portfolio, increased directors fees, franchise tax expense, and regulatory and audit fees.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was 51.9% and 53.0% for the three and six months ended June 30, 2016 compared to 51.1% and 52.0% for the three and six months ended June 30, 2015. The efficiency ratio measures the amount of expense that is incurred to generate a dollar of revenue. The efficiency ratio for the quarter and year-to-date periods ended June 30, 2016 was negatively impacted by merger-related charges.

Income Taxes. During the three and six months ended June 30, 2016, we recorded income tax expense of $15.8 million and $29.6 million compared to $11.3 million and $22.0 million for the three and six months ended June 30, 2015. Our income tax expense for the year-to-date period ended June 30, 2016 reflects an effective income tax rate of 33.5% compared to 33.1% for the year-to-date period ended June 30, 2015. Our effective tax rate differs from the statutory tax rate by our investments in municipal securities, our real estate investment trust, participation in the Community Investment Tax Credit program and bank-owned life insurance offset in part by limited deductibility of meals and entertainment expense.

Financial Condition

Our consolidated balance sheet at June 30, 2016 reflects an increase in total loans outstanding to $7.091 billion at June 30, 2016 compared to $6.543 billion at December 31, 2015. Total deposits increased by $321.4 million between December 31, 2015 and June 30, 2016. Total assets were $9.736 billion at June 30, 2016 compared to $8.715 billion at December 31, 2015.

Loans. The composition of loans at June 30, 2016 and at December 31, 2015 and the percentage (%) of each classification to total loans are summarized as follows (dollars in thousands):

| | June 30, 2016 | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| | Amount | Percent | | Amount | Percent | |
| Commercial real estate – mortgage | $2,467,219 | 34.8 | % | $2,275,483 | 34.8 | % |
| Consumer real estate – mortgage | 1,068,620 | 15.1 | % | 1,046,517 | 16.0 | % |
| Construction and land development | 816,681 | 11.5 | % | 747,697 | 11.4 | % |
| Commercial and industrial | 2,492,016 | 35.1 | % | 2,228,542 | 34.1 | % |
| Consumer and other | 246,866 | 3.5 | % | 244,996 | 3.7 | % |
| Total loans | $7,091,402 | 100.0 | % | $6,543,235 | 100.0 | % |

At June 30, 2016, our loan portfolio composition remained relatively consistent with the composition at December 31, 2015. The commercial real estate – mortgage category includes owner-occupied commercial real estate loans which is similar in many ways to our commercial and industrial lending in that these loans are generally made to businesses on the basis of the cash flows of the business rather than on the valuation of the real estate. At June 30, 2016, approximately 45.2% of the outstanding principal balance of our commercial real estate mortgage loans was secured by owner-occupied properties. Growth in the construction and development loan segment reflects the development of the local economies in which we participate and is diversified between commercial, residential and land.
The following table classifies our fixed and variable rate loans at June 30, 2016 according to contractual maturities of (1) one year or less, (2) after one year through five years, and (3) after five years. The table also classifies our variable rate loans pursuant to the contractual repricing dates of the underlying loans (dollars in thousands):

| | Amounts at June 30, 2016 | | | Percentage At June 30, 2016 | |
|---|---|---|---|---|---|
| | Fixed Rates | Variable Rates | Totals | | |
| Based on contractual maturity: | | | | | |
| Due within one year | $335,262 | $1,182,726 | $1,517,988 | 21.4 | % |
| Due in one year to five years | 1,741,940 | 1,440,904 | 3,182,844 | 44.9 | % |
| Due after five years | 922,273 | 1,468,297 | 2,390,570 | 33.7 | % |
| Totals | $2,999,475 | $4,091,927 | $7,091,402 | 100.0 | % |
| | | | | | |
| Based on contractual repricing dates: | | | | | |
| Daily floating rate (*) | $- | $1,704,152 | $1,704,152 | 24.0 | % |
| Due within one year | 335,262 | 2,047,589 | 2,382,851 | 33.6 | % |

| | | | | | |
|---|---|---|---|---|---|
| Due in one year to five years | 1,741,940 | 291,269 | 2,033,209 | 28.7 | % |
| Due after five years | 922,273 | 48,917 | 971,190 | 13.7 | % |
| Totals | $2,999,475 | $4,091,927 | $7,091,402 | 100.0 | % |

The above information does not consider the impact of scheduled principal payments.

(*) Daily floating rate loans are tied to Pinnacle Bank's prime lending rate or a national interest rate index with the underlying loan rates changing in relation to changes in these indexes. Interest rate floors are currently in effect on approximately $297.0 million of our daily floating rate loan portfolio and on approximately $330.0 million of the remaining variable rate loan portfolio at varying maturities. The weighted average rate of the floors for the daily floating rate portfolio is 4.57% compared to the average coupon of 3.76% for this portfolio. The weighted average rate of the floors for the remaining variable rate portfolio is 4.29% compared to the average coupon rate of 3.51% for this portfolio. As a result, interest income on these loans will not adjust until the contractual rate on the underlying loan exceeds the interest rate floor.

Accruing Loans in Past Due Status. The following table is a summary of our accruing loans that were past due at least 30 days but less than 89 days and 90 days or more past due as of June 30, 2016 and December 31, 2015 (dollars in thousands):

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Accruing loans past due 30 to 89 days: | | |
| Commercial real estate – mortgage | $1,015 | $ - |
| Consumer real estate – mortgage | 5,476 | 6,380 |
| Construction and land development | 8,199 | 309 |
| Commercial and industrial | 1,166 | 4,798 |
| Consumer and other | 6,252 | 6,721 |
| Total accruing loans past due 30 to 89 days | $22,108 | $ 18,208 |
| | | |
| Accruing loans past due 90 days or more: | | |
| Commercial real estate – mortgage | $- | $ - |
| Consumer real estate – mortgage | 1,046 | 1,396 |
| Construction and land development | - | - |
| Commercial and industrial | - | - |
| Consumer and other | 577 | 373 |
| Total accruing loans past due 90 days or more | $1,623 | $ 1,769 |
| | | |
| Ratios: | | |
| Accruing loans past due 30 to 89 days as a percentage of total loans | 0.31 % | 0.28 % |
| Accruing loans past due 90 days or more as a percentage of total loans | 0.02 % | 0.03 % |
| Total accruing loans in past due status as a percentage of total loans | 0.33 % | 0.31 % |

Potential Problem Loans. Potential problem loans, which are not included in nonperforming assets, amounted to approximately $98.1 million or 1.4% of total loans at June 30, 2016 compared to $105.0 million or 1.6% of total loans at December 31, 2015. 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 serious 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 substandard nonaccrual loans and substandard troubled debt restructurings. Troubled debt restructurings are not included in potential problem loans. Approximately $447,000 of potential problem loans were past due at least 30 days but less than 90 days as of June 30, 2016.

Nonperforming Assets and Troubled Debt Restructurings. At June 30, 2016, we had $39.0 million in nonperforming assets compared to $36.4 million at December 31, 2015. Included in nonperforming assets were $33.8 million in nonaccrual loans, $5.0 million in OREO and $177,000 in other repossessed assets at June 30, 2016 and $29.4 million in nonaccrual loans, $5.1 million in OREO and $1.9 million of other repossessed assets at December 31, 2015. At June 30, 2016 and December 31, 2015, there were $9.9 million and $8.1 million, respectively, of troubled debt restructurings, all of which were accruing as of the restructured date and remain on accrual status but are considered impaired loans pursuant to U.S. GAAP.

Allowance for Loan Losses (allowance). We maintain the allowance at a level that our management deems appropriate to adequately cover the probable losses inherent in the loan portfolio. As of June 30, 2016 and December 31, 2015, our allowance for loan losses was approximately $61.4 million and $65.4 million, respectively, which our management deemed to be adequate at each of the respective dates. Purchased loans were recorded at fair value upon acquisition with an aggregate balance of $1.3 billion and an aggregate fair value adjustment of $33.4 million of which $6.1 million was attributable to purchase credit impaired loans and will not be accreted into income. Since the acquisition date, approximately $13.3 million has been recorded as income, resulting from the accretion of the fair value discount over the remaining life of the underlying loan or upon the settlement of the underlying credit. These loans are subject to the same allowance methodology as our legacy portfolio. The calculated allowance is compared to the remaining fair value discount, on a loan-by-loan basis, to determine if additional provisioning should be recognized. At June 30, 2016, $3.3 million of our allowance for loan losses related to purchased loans resulting from either additional draws or from credit deterioration compared to $3.2 million of our allowance for loan losses at December 31, 2015. The judgments and estimates associated with our allowance determination are described under Critical Accounting Estimates in our Annual Report on Form 10-K for the year ended December 31, 2015.

The following table sets forth, based on management's best estimate, the allocation of the allowance to categories of loans as well as the unallocated portion as of June 30, 2016 and December 31, 2015 and the percentage of loans in each category to total loans (dollars in thousands):

| | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| | Amount | Percent | Amount | Percent |
| Commercial real estate - mortgage | $13,665 | 34.8 % | $15,513 | 34.8 % |
| Consumer real estate - mortgage | 6,540 | 15.1 % | 7,220 | 16.0 % |
| Construction and land development | 3,923 | 11.5 % | 2,903 | 11.4 % |
| Commercial and industrial | 25,090 | 35.1 % | 23,643 | 34.1 % |
| Consumer and other | 11,138 | 3.5 % | 15,616 | 3.7 % |
| Unallocated | 1,056 | NA | 537 | NA |
| Total allowance for loan losses | $61,412 | 100.0 % | $65,432 | 100.0 % |

The following is a summary of changes in the allowance for loan losses for the year-to-date period ended June 30, 2016 and for the year ended December 31, 2015 and the ratio of the allowance for loan losses to total loans as of the end of each period (dollars in thousands):

| | Six months ended June 30, 2016 | Year ended December 31, 2015 |
|---|---|---|
| Balance at beginning of period | $65,432 | $67,359 |
| Provision for loan losses | 9,174 | 9,188 |
| Charged-off loans: | | |
| Commercial real estate – mortgage | (196) | (384) |
| Consumer real estate – mortgage | (379) | (365) |
| Construction and land development | - | (190) |
| Commercial and industrial | (2,243) | (2,207) |
| Consumer and other loans | (13,555) | (18,002) |
| Total charged-off loans | (16,373) | (21,148) |
| Recoveries of previously charged-off loans: | | |
| Commercial real estate – mortgage | 193 | 85 |
| Consumer real estate – mortgage | 156 | 874 |
| Construction and land development | 106 | 1,479 |
| Commercial and industrial | 1,615 | 1,730 |
| Consumer and other loans | 1,109 | 5,865 |
| Total recoveries of previously charged-off loans | 3,179 | 10,033 |
| Net charge-offs | (13,194) | (11,115) |
| Balance at end of period | $61,412 | $65,432 |
| Ratio of allowance for loan losses to total loans outstanding at end of period | 0.87 % | 1.00 % |
| Ratio of net charge-offs to average total loans outstanding for the period (1) | 0.39 % | 0.21 % |

(1) Net charge-offs for the year-to-date period ended June 30, 2016 have been annualized.

Management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolio, past loan loss experience, known and inherent risks in the portfolio, the views of Pinnacle Bank's regulators, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. For further discussion regarding our allowance for loan losses, refer to the Annual Report on Form 10-K as of and for the year ended December 31, 2015.

Investments. Our investment portfolio, consisting primarily of U.S. Treasuries, Federal agency bonds, mortgage-backed securities, and state and municipal securities amounted to $1.1 billion and $966.4 million at June 30, 2016 and December 31, 2015, respectively. Our investment portfolio serves many purposes including serving as a stable source of income, as collateral for public funds deposits and as a potential liquidity source. A summary of our investment portfolio at June 30, 2016 and December 31, 2015 follows:

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Weighted average life | 4.0 years | 4.90 years |
| Effective duration | 2.38% | 3.04% |
| Weighted average coupon | 2.97% | 3.04% |
| Tax equivalent yield | 2.49% | 2.45% |

Deposits and Other Borrowings. We had approximately $7.293 billion of deposits at June 30, 2016 compared to $6.971 billion at December 31, 2015. Our deposits consist of noninterest and interest-bearing demand accounts, savings accounts, money market accounts and time deposits. Additionally, we entered into agreements with certain customers to sell certain securities under agreements to repurchase the security the following day. These agreements (which are typically associated with comprehensive treasury management programs for our clients and provide them with short-term returns for their excess funds) amounted to $73.3 million at June 30, 2016 and $79.1 million at December 31, 2015. Additionally, at June 30, 2016 and December 31, 2015, Pinnacle Bank had borrowed $783.2 million and $300.3 million, respectively, in advances from the FHLB. At June 30, 2016, Pinnacle Bank had approximately $523.0 million in additional availability with the FHLB.

Generally, we have classified our funding base as either core funding or non-core funding. Core funding consists of all deposits other than time deposits issued in denominations greater than $250,000. All other funding is deemed to be non-core. The following table represents the balances of our deposits and other funding and the percentage of each type to the total at June 30, 2016 and December 31, 2015 (dollars in thousands):

| | June 30, 2016 | Percent | December 31, 2015 | Percent |
|---|---|---|---|---|
| Core funding: | | | | |
| Noninterest-bearing deposit accounts | $2,013,847 | 24.0 % | $1,889,865 | 25.2 % |
| Interest-bearing demand accounts | 1,284,593 | 15.3 % | 1,355,405 | 18.1 % |
| Savings and money market accounts | 2,843,895 | 33.9 % | 2,683,046 | 35.8 % |
| Time deposit accounts less than $250,000 | 448,727 | 5.4 % | 404,494 | 5.4 % |
| Total core funding | 6,591,062 | 78.7 % | 6,332,810 | 84.5 % |
| Non-core funding: | | | | |
| Relationship based non-core funding: | | | | |
| Reciprocating NOW deposits (1) | 32,060 | 0.4 % | 34,144 | 0.5 % |
| Reciprocating money market accounts (1) | 393,108 | 4.7 % | 318,905 | 4.3 % |
| Reciprocating time deposits | 11,571 | 0.1 % | 50,203 | 0.7 % |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other time deposits | 150,298 | 1.8 | % | 228,064 | 3.0 | % |
| Securities sold under agreements to repurchase | 73,317 | 0.9 | % | 79,084 | 1.1 | % |
| Total relationship based non-core funding | 660,354 | 7.9 | % | 710,400 | 9.5 | % |
| Wholesale funding: | | | | | | |
| Brokered deposits | 114,727 | 1.4 | % | 7,288 | 0.1 | % |
| Federal Home Loan Bank advances | 783,240 | 9.4 | % | 300,305 | 4.0 | % |
| Subordinated debt - Pinnacle Bank | 147,238 | 1.8 | % | 60,000 | 0.8 | % |
| Subordinated debt- Pinnacle Financial | 82,476 | 1.0 | % | 82,476 | 1.1 | % |
| Total wholesale funding | 1,127,681 | 13.5 | % | 450,069 | 6.0 | % |
| Total non-core funding | 1,788,035 | 21.3 | % | 1,160,469 | 15.5 | % |
| Totals | $8,379,097 | 100.0 | % | $7,493,279 | 100.0 | % |

(1) The reciprocating categories consists of deposits we receive from a bank network (the CDARS network) in connection with deposits of our customers in excess of our FDIC coverage limit that we place with the CDARS network.

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Our funding policies impose limits on the amount of non-core funding we can utilize.  Periodically, we may exceed our policy limitations, at which time management will develop plans to bring our core funding ratios back within compliance.  At June 30, 2016 and December 31, 2015, we were in compliance with our core funding policies. As noted in the table above, our core funding as a percentage of total funding decreased from 84.5% at December 31, 2015 to 78.7% at June 30, 2016, primarily as a result of our increased FHLB advances used to fund loan growth that outpaced deposit growth.

Continuing to grow our core deposit base is a key strategic objective of our firm. We have numerous commercial and affluent consumer depositors that maintain significant balances in their transaction and money market accounts. These deposits are subject to significant fluctuations from time to time for such purposes as distributions to owners, taxes, business acquisitions, etc. As a result, our core funding ratios may also fluctuate meaningfully based on these factors.

The amount of time deposits as of June 30, 2016 amounted to $725.3 million.  The following table shows our time deposits in denominations of $100,000 and less and in denominations greater than $100,000 by category based on time remaining until maturity and the weighted average rate for each category (in thousands):

| | Balances | Weighted Avg. Rate | |
|---|---|---|---|
| Denominations less than $100,000 | | | |
| Three months or less | $43,616 | 0.58 | % |
| Over three but less than six months | 38,968 | 1.61 | % |
| Over six but less than twelve months | 61,991 | 1.80 | % |
| Over twelve months | 46,963 | 2.99 | % |
| | $191,538 | 1.78 | % |
| Denominations $100,000 and greater | | | |
| Three months or less | $132,676 | 0.57 | % |
| Over three but less than six months | 157,658 | 0.72 | % |
| Over six but less than twelve months | 129,400 | 0.78 | % |
| Over twelve months | 114,051 | 0.54 | % |
| | $533,785 | 0.66 | % |
| Totals | $725,323 | 0.95 | % |

Subordinated debt and other borrowings.  We have four wholly-owned subsidiaries that are statutory business trusts. We are the sole sponsor of the Trusts and acquired each Trust's common securities. The Trusts were created for the exclusive purpose of issuing 30-year capital trust preferred securities and using the proceeds to acquire junior subordinated debentures (Subordinated Debentures) issued by ourselves.  The sole assets of the Trusts are the Subordinated Debentures.  At June 30, 2016, our $2,476,000 investment in the Trusts is included in other investments in the accompanying consolidated balance sheets and our $82,476,000 obligation is reflected as subordinated debt.

| | Date Established | Maturity | Common Securities | Subordinated Debentures | Floating Interest Rate | Interest Rate at June 30, 2016 | |
|---|---|---|---|---|---|---|---|
| Trust I | December 29, 2003 | December 30, 2033 | $310,000 | $10,000,000 | Libor + 2.80% | 3.46 | % |
| Trust II | September 15, 2005 | September 30, 2035 | 619,000 | 20,000,000 | Libor + 1.40% | 2.03 | % |
| Trust III | September 7, 2006 | September 30, 2036 | 619,000 | 20,000,000 | Libor + 1.65% | 2.28 | % |
| Trust IV | October 31, 2007 | September 30, 2037 | 928,000 | 30,000,000 | Libor + 2.85% | 3.50 | % |

The Trust Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR which is set each quarter.  Distributions are payable quarterly.  The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption.  We guarantee the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trusts.  Our obligations under the Subordinated Debentures together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by ourselves of the obligations of the Trusts under the Trust Preferred Securities.

The Subordinated Debentures are unsecured, bear interest at a rate equal to the rates paid by the Trusts on the Trust Preferred Securities and mature on the same dates as those noted above for the Trust Preferred Securities. Interest is payable quarterly. We may defer the payment of interest at any time for a period not exceeding 20 consecutive quarters provided that the deferral period does not extend past the stated maturity. During any such deferral period, distributions on the Trust Preferred Securities will also be deferred and our ability to pay dividends on our common shares and preferred shares will be restricted.

The Trust Preferred Securities may be redeemed prior to maturity at our option. The Trust Preferred Securities may also be redeemed at any time in whole (but not in part) in the event of unfavorable changes in laws or regulations that result in (1) the Trust becoming subject to federal income tax on income received on the Subordinated Debentures, (2) interest payable by the parent company on the Subordinated Debentures becoming non-deductible for federal tax purposes, (3) the requirement for the Trust to register under the Investment Company Act of 1940, as amended, or (4) loss of the ability to treat the trust preferred securities as "Tier I capital" under the Federal Reserve capital adequacy guidelines. Under current Federal Reserve regulations, the trust preferred securities qualify as Tier 1 capital. The Federal Reserve published final Basel III capital regulations in June 2013 which continued the treatment of preferred securities as Tier I capital for holding companies under $15.0 billion in assets.

On July 30, 2015, Pinnacle Bank issued $60.0 million in aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes due 2025 (Notes) in a private placement transaction to accredited institutional investors. On March 10, 2016, Pinnacle Bank issued an additional $70.0 million in aggregate principal amount of the Notes. The Notes issued on March 10, 2016 were priced at 99.023% of the principal amount per note, for an effective interest rate of 5.125%. The maturity date of the Notes is July 30, 2025, although Pinnacle Bank may redeem some or all of the Notes beginning on the interest payment date of July 30, 2020 and on any interest payment date thereafter at a redemption price equal to 100% of the principal amount of the Notes to be redeemed plus accrued and unpaid interest to the date of redemption, subject to the prior approval of the FDIC.

From the date of the issuance through July 29, 2020, the Notes will bear interest at the rate of 4.875% per year and will be payable semi-annually in arrears on January 30 and July 30 of each year, beginning on January 30, 2016. From July 30, 2020, the Notes will bear interest at a rate per annum equal to the three-month LIBOR rate plus 3.128%, payable quarterly in arrears on each January 30, April 30, July 30, and October 30, beginning on July 30, 2020, through the maturity date or the early redemption date of the Notes.

Pinnacle Bank used the net proceeds from the June 30, 2015 offering, together with available cash, to pay the cash portion of the merger consideration payable to the shareholders of CapitalMark and Magna in connection with those mergers, to pay the amounts necessary to redeem the preferred shares that each of CapitalMark and Magna had issued to the United States Department of the Treasury in connection with their participation in the Treasury's Small Business Lending Fund and for general corporate purposes. The sale of the Notes on March 10, 2016 yielded net proceeds of approximately $68.3 million after deducting the placement agents' fees and expenses payable by Pinnacle Bank. Pinnacle Bank used the net proceeds from the offering for general corporate purposes, (including the repayment of short term borrowings of Pinnacle Bank used to pay a portion of the cash portion of the purchase price for the additional equity interests of BHG acquired by Pinnacle Bank on March 1, 2016).

On March 29, 2016, Pinnacle Financial entered into a revolving credit facility with a bank for borrowings of up to $75 million under a loan agreement Pinnacle Financial entered into with the bank (the Loan Agreement). Borrowings under the revolving credit facility are anticipated to be used to fund the cash portion of the purchase price and the transaction costs associated with acquisitions made by Pinnacle Financial from time to time and for general corporate purposes including to fund capital contributions to Pinnacle Bank. Pinnacle Financial's borrowings under the Loan Agreement bear interest at a rate equal to 2.25% plus the greater of (i) zero percent (0%) or (ii) the one-month LIBOR rate quoted by the lender. The Loan Agreement also requires Pinnacle Financial to pay a quarterly fee beginning June 30, 2016 equal to 0.35% per annum on the average daily unused amount of available borrowings. As of June 30, 2016, there were $19.8 million of borrowings under the Loan Agreement, net of associated debt issuance costs, which were used to fund a capital contribution to Pinnacle Bank. Pinnacle Financial borrowed an additional $10.0 million on July 1, 2016 to fund a portion of the cash portion of the merger consideration payable to Avenue's shareholders.

In addition, upon consummation of the Avenue Merger, Pinnacle Financial assumed Avenue's obligations under its outstanding $20.0 million subordinated notes issued in December 2014 (the Avenue Subordinated Notes) that mature in December 2024. The Avenue Subordinated Notes bear interest at a rate of 6.75% per annum until January 1, 2020 and may not be redeemed prior to such date. Beginning on January 1, 2020, if not redeemed on such date, the Avenue Subordinated 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%. Interest on the Avenue Subordinated Notes is payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, through December 29, 2024 or the earlier date of redemption of all the Avenue Subordinated Notes. The Avenue Subordinated Notes are not subject to redemption at the option of the holders. These notes will be recorded at fair value as of the acquisition date.

Capital Resources. At June 30, 2016 and December 31, 2015, our stockholders' equity amounted to $1.3 billion and $1.2 billion, respectively, an increase of approximately $106.5 million. Approximately $39.7 million of this increase is attributable to equity issued in connection with our supplemental investment in BHG. The remaining increase is attributable to net income, equity compensation and changes in our other comprehensive income.

Dividends. Pursuant to Tennessee banking law, our bank may not, without the prior consent of the TDFI, pay any dividends to us in a calendar year in excess of the total of our bank's retained net profits for that year plus the retained net profits for the preceding two years. During the six months ended June 30, 2016, our bank paid dividends of $12.9 million to us which is within the limits allowed by the TDFI.

During the six months ended June 30, 2016, we paid $11.7 million in dividends to common shareholders. On July 19, 2016, our Board of Directors declared a $0.14 per share quarterly cash dividend to common shareholders which should approximate $6.5 million in aggregate dividend payments that will be paid on August 26, 2016 to common shareholders of record as of the close of business on August 5, 2016. The amount and timing of all future dividend payments, if any, is subject to Board discretion and will depend on our earnings, capital position, financial condition and other factors, including new regulatory capital requirements, as they become known to us.

Market and Liquidity Risk Management

Our objective is to manage assets and liabilities to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies. Our Asset Liability Management Committee (ALCO) is charged with the responsibility of monitoring these policies, which are designed to ensure acceptable composition of asset/liability mix. Two critical areas of focus for ALCO are interest rate sensitivity and liquidity risk management.

Interest Rate Sensitivity. In the normal course of business, we are exposed to market risk arising from fluctuations in interest rates. ALCO measures and evaluates the interest rate risk so that we can meet customer demands for various types of loans and deposits. ALCO determines the most appropriate amounts of on-balance sheet and off-balance sheet items. Measurements which we use to help us manage interest rate sensitivity include an earnings simulation model and an economic value of equity ("EVE") model.

Our interest rate sensitivity modeling incorporates a number of assumptions for both earnings simulation and EVE, including loan and deposit re-pricing characteristics, the rate of loan prepayments, etc. ALCO periodically reviews these assumptions for accuracy based on historical data and future expectations. Our ALCO policy requires that the base scenario assume rates remain flat and is the scenario to which all others are compared in order to measure the change in net interest income and EVE. Policy limits are applied to the results of certain modeling scenarios. While the primary policy scenarios focus on a twelve month time frame, longer time horizons are also modeled. All policy scenarios assume a static balance sheet, although other scenarios are modeled.

<u>Earnings simulation model.</u> We believe interest rate risk is best measured by our earnings simulation modeling. Earning assets, interest-bearing liabilities and off-balance sheet financial instruments are combined with forecasts of interest rates for the next 12 months and are combined with other factors in order to produce various earnings simulations. To limit interest rate risk, we have policy guidelines for our earnings at risk which seek to limit the variance of net interest income in both gradual and instantaneous changes to interest rates. For changes up or down in rates from management's flat interest rate forecast over the next twelve months, management establishes policy limits in the decline in net interest income for the following scenarios:

- +/- 10.0% for a gradual change of 400 points; +/-20.0% for an instantaneous change of 400 basis points
- +/- 7.5% for a gradual change of 300 points; +/- 15.0% for an instantaneous change of 300 basis points
- +/- 5.0% for a gradual change of 200 points; +/- 10.0% for an instantaneous change of 200 basis points

· +/- 2.5% for a gradual change of 100 points; +/- 5.0% for an instantaneous change of 100 basis points

At June 30, 2016, our earnings simulation model indicated we were in compliance with our policies for both the gradual and instantaneous interest rate changes.

Economic value of equity. Our EVE model measures the extent that estimated economic values of our assets, liabilities and off-balance sheet items will change as a result of interest rate changes. Economic values are determined by discounting expected cash flows from assets, liabilities and off-balance sheet items, which establishes a base case EVE. To help limit interest rate risk, we have stated policy guidelines for an instantaneous basis point change in interest rates, in the following scenarios:

- +/- 400 basis point change in interest rates, EVE shall not decrease by more than 40 percent
- +/- 300 basis point change in interest rates, EVE shall not decrease by more than 30 percent
- +/- 200 basis point change in interest rates, EVE shall not decrease by more than 20 percent
- +/- 100 basis point change in interest rates, EVE shall not decrease by more than 10 percent

At June 30, 2016, our EVE model indicated we were in compliance with our policies noted above. However, our policies provide that during certain interest rate cycles, the down basis point rate changes may not be particularly significant given the current slope of the yield curve. Accordingly, we have currently suspended the calculation of the down rate scenarios for EVE measurement for the down 300 and down 400 scenarios.

Another commonly analyzed scenario is a most-likely earnings simulation scenario that projects the expected change in rates based on a forward yield curve adopted by management using expected balance sheet volumes forecasted by management. Separate growth assumptions are developed for loans, investments, deposits, etc. Other interest rate scenarios analyzed by management may include delayed rate shocks, yield curve steepening or flattening, or other variations in rate movements to further analyze or stress our balance sheet under various interest rate scenarios.

Each of the above analyses may not, on its own, be an accurate indicator of how our net interest income will be affected by changes in interest rates. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be affected uniformly by changes in interest rates. In addition, the magnitude and duration of changes in interest rates may have a significant impact on net interest income. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities fluctuate in advance of changes in general market rates, while interest rates on other types may lag behind changes in general market rates. In addition, certain assets, such as adjustable rate mortgage loans, have features (generally referred to as interest rate caps and floors) which limit changes in interest rates. Prepayment and early withdrawal levels also could deviate significantly from those assumed in calculating the maturity of certain instruments. The ability of many borrowers to service their debts also may decrease during periods of rising interest rates. ALCO reviews each of the above interest rate sensitivity analyses along with several different interest rate scenarios as part of its responsibility to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies.

We may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities and as one tool to manage our interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. We may also enter into interest rate swaps to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, even though they are not designated as hedging instruments.

Based on information gathered from these various modeling scenarios, management believes that at June 30, 2016, our balance sheet would likely be asset sensitive.

ALCO may determine that Pinnacle Financial should over time become more or less asset or liability sensitive depending on the underlying balance sheet circumstances and the firm's conclusions as to anticipated interest rate fluctuations in future periods. At present, ALCO has determined that its "most likely" rate scenario considers an initial rise in short-term interest rates in late-2016 and that such rates will increase gradually over several quarters while the longer end of the rate curve will rise only slightly. The firm's "most likely" rate forecast is based primarily on information we acquire from a service which includes a consensus forecast of numerous benchmarks. As a result and in preparing for an eventual rise in interest rates, we have implemented the following strategies:

- Reduced our exposure to fixed rate investment securities in relation to total assets from approximately 23% as of December 31, 2010 to a current position of approximately 12% of total assets. This reduction should assist us in becoming more asset sensitive over time.
- Executed a series of cash flow hedges involving approximately $200 million in FHLB borrowings at pre-established fixed rates. Fixed rate liabilities also provide for a more asset sensitive balance sheet.
- Participated in interest rate swaps whereby our customers pay a fixed rate which we remit to our counterparty while we receive in return a floating rate on these commercial loans. These loans amounted to approximately $578.0 million at June 30, 2016. Floating rate loans promote an asset sensitive balance sheet.
- Reduced the amount of "in the money" rate floors attached to floating and variable rate commercial loans from $1.100 billion at December 31, 2013 to $627.0 million as of June 30, 2016 thus promoting a more asset sensitive balance sheet over time.
- Reduced the difference between the weighted average floor rate on floating and variable rate commercial loans and the weighted average contract rate on these type of loans from 0.81% at December 31, 2015 to 0.80% at June 30, 2016. This reduction results in requiring a lesser increase in shorter-term rates for the floors to be overcome, thus making these loans with rate floors more asset sensitive over time.

We believe current growth in our balance sheet will also assist us in achievement of increased asset sensitivity over time; however, we may also implement a series of actions designed to accelerate our achievement of neutrality or asset sensitivity as conditions warrant.

Liquidity Risk Management. The purpose of liquidity risk management is to ensure that there are sufficient cash flows to satisfy loan demand, deposit withdrawals, and our other needs. Traditional sources of liquidity for a bank include asset maturities and growth in core deposits. A bank may achieve its desired liquidity objectives from the management of its assets and liabilities and by internally generated funding through its operations. Funds invested in marketable instruments that can be readily sold and the continuous maturing of other earning assets are sources of liquidity from an asset perspective. The liability base provides sources of liquidity through attraction of increased deposits and borrowing funds from various other institutions.

To assist in determining the adequacy of our liquidity, we perform a variety of liquidity stress tests including idiosyncratic, systemic and combined scenarios for both moderate and severe events. Liquidity is defined as the ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining our ability to meet the daily cash flow requirements of our customers, both depositors and borrowers. We maintain a minimum liquid asset balance to ensure our ability to meet our obligations. The size of the minimum liquid asset balance is determined through severe liquidity stress testing. At June 30, 2016, we were in compliance with our liquidity coverage ratio.

Changes in interest rates also affect our liquidity position. We currently price deposits in response to market rates and our management intends to continue this policy. If deposits are not priced in response to market rates, a loss of deposits could occur which would negatively affect our liquidity position.

Scheduled loan payments are a relatively stable source of funds, but loan payoffs and deposit flows fluctuate significantly, being influenced by interest rates, general economic conditions and competition. Additionally, debt security investments are subject to prepayment and call provisions that could accelerate their payoff prior to stated maturity. We attempt to price our deposit products to meet our asset/liability objectives consistent with local market conditions. Our ALCO is responsible for monitoring our ongoing liquidity needs. Our regulators also monitor our liquidity and capital resources on a periodic basis.

In addition, our bank is a member of the FHLB. As a result, our bank receives advances from the FHLB, pursuant to the terms of various borrowing agreements, which assist it in the funding of its home mortgage and commercial real estate loan portfolios. Under the borrowing agreements with the FHLB, our bank has pledged certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans as collateral. At June 30, 2016, our bank had received advances from the FHLB totaling $783.2 million at the following rates and maturities (dollars in thousands):

| Scheduled Maturities | Amount | Interest Rates[1] | |
|---|---|---|---|
| 2016 | $650,000 | 0.56 | % |
| 2017 | 133,000 | 0.76 | % |
| 2018 | 3 | 2.00 | % |
| 2019 | - | 0.00 | % |
| 2020 | 209 | 2.25 | % |
| Thereafter | 28 | 2.75 | % |
| Total | $783,240 | | |
| Weighted average interest rate | | 0.59 | % |

[1] Some FHLB advances include variable interest rates and could increase in the future. The table reflects rates in effect as of June 30, 2016.

Our bank also has accommodations with upstream correspondent banks available for unsecured short-term advances which aggregate $140.0 million. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within a month. There were no outstanding borrowings at June 30, 2016, or during the quarter then ended under these agreements. Our bank also has approximately $1.5 billion in available Federal Reserve discount window lines of credit.

At June 30, 2016, excluding reciprocating time deposits issued through the CDARS network, we had $114.7 million of brokered certificates of deposit. Historically, we have issued brokered certificates through several different brokerage houses based on competitive bid. Typically, these funds have been for varying maturities of up to two years and were issued at rates which were competitive to rates we would be required to pay to attract similar deposits within our local markets as well as rates for FHLB advances of similar maturities. Although we consider these deposits to be a ready source of liquidity under current market conditions, we anticipate that these deposits will not represent a significant percentage of our total funding in 2016 as we seek to maintain a significant portion of our funding in the form of core deposits.

At June 30, 2016, we had no significant commitments for capital expenditures, although we intend to construct a new retail location in each of the Knoxville, Chattanooga and Memphis MSAs annually as we expand our footprint in these newer markets. Our management believes that we have adequate liquidity to meet all known contractual obligations and unfunded commitments, including loan commitments and reasonable borrower, depositor, and creditor requirements over the next twelve months.

Industry regulators have defined additional liquidity guidelines, through the issuance of the Basel III Liquidity Coverage Ratio (LCR) and the Modified LCR, for banking institutions greater than $250 billion in assets, and $50 billion in assets respectively, in the United States. These regulatory guidelines became effective January 2015 with phase in over subsequent years and will require these large institutions to follow prescriptive guidance in determining an absolute level of a high quality liquid asset (HQLA) buffer that must be maintained on their balance sheets in order to withstand a potential liquidity crisis event. Although Pinnacle follows the principles outlined in the Interagency Policy Statement on Liquidity Risk Management, issued March 2010, to determine its HQLA buffer, Pinnacle is not currently subject to these regulations. However, these formulas could eventually be imposed on smaller banks, such as Pinnacle Bank, and require an increase in the absolute level of liquidity on our balance sheet. Consequently, this could result in lower net interest margins for us in future periods.

Off-Balance Sheet Arrangements. At June 30, 2016, we had outstanding standby letters of credit of $101.8 million and unfunded loan commitments outstanding of $2.5 billion. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, Pinnacle Bank has the ability to liquidate Federal funds sold or on a short-term basis to borrow and purchase Federal funds from other financial institutions.

Impact of Inflation

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with U.S. GAAP and practices within the banking industry which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation.

Recent Accounting Pronouncements

Except as set forth below, there are currently no new accounting standards that have been issued that will have a significant impact on the Company's financial position, results of operations or cash flows upon adoption that were not disclosed in the Company's most recent Annual Report on Form 10-K.

In February 2016, the FASB issued Accounting Standards Update 2016-02 Leases guidance requiring the recognition in the statement of financial position of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The guidance requires that a lessee should recognize lease assets and lease liabilities as compared to previous GAAP that did not require lease assets and lease liabilities to be recognized for most leases. The guidance becomes effective for us on January 1, 2019. Pinnacle Financial is currently evaluating the impact on our financial statements.

In March 2016, the FASB issued updated guidance to Accounting Standards Update 2016-09 Stock Compensation Improvements to Employee Share-Based Payment Activity intended to simplify and improve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of such awards as either equity or liabilities and classification on the statement of cash flows. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. Pinnacle Financial is currently assessing the impact of the new guidance on its consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments (the ASU), which introduces the current expected credit losses methodology. Among other things, the ASU requires the measurement of all expected credit losses for financial assets, including available-for-sale debt securities, held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The new model will require institutions to calculate all probable and estimable losses that are expected to be incurred through the financial asset's entire life. ASU 2016-13 also requires the allowance for credit losses for purchased financial assets with credit deterioration since origination to be determined in a manner similar to that of other financial assets measured at amortized cost; however, the initial allowance will be added to the purchase price rather than recorded as credit loss expense. The disclosure of credit quality indicators related to the amortized cost of financing receivables will be further disaggregated by year of origination (or vintage). Disaggregation by vintage will be optional for nonpublic business entities. Institutions are to apply the changes through a cumulative-effect adjustment to their retained earnings as of the beginning of the first reporting period in which the standard is effective. The amendments are effective for fiscal years beginning after December 15, 2020. Early application will be permitted for fiscal years beginning after December 15, 2018. Pinnacle Financial is currently assessing the impact of the new guidance on its consolidated financial statements.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this Item 3 is included on pages 40 through 59 of Part I - Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations."

## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

Pinnacle Financial maintains disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by it in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to Pinnacle Financial's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Pinnacle Financial carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that Pinnacle Financial's disclosure controls and procedures were effective.

### Changes in Internal Controls

There were no changes in Pinnacle Financial's internal control over financial reporting during Pinnacle Financial's fiscal quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, Pinnacle Financial's internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Various legal proceedings to which Pinnacle Financial or a subsidiary of Pinnacle Financial is a party arise from time to time in the normal course of business. Except as noted below, there are no material pending legal proceedings to which Pinnacle Financial or a subsidiary of Pinnacle Financial is a party or of which any of their property is the subject.

On May 9, 2016 a purported class action complaint was filed in the Chancery Court for the State of Tennessee, 20th Judicial District at Nashville, styled Stephen Bushansky, on behalf of himself and all others similarly situated, Plaintiff, versus Avenue Financial Holdings, Inc. Ronald L. Samuels, Kent Cleaver, David G. Anderson, Agenia Clark, James F. Deutsch, Marty Dickens, Patrick G. Emery, Nancy Falls, Joseph C. Galante, David Ingram. Stephen Moore, Ken Robold, Karen Saul and Pinnacle Financial Partners, Inc., Defendants (Case No. 16-489-IV), alleging that the individual defendants breached their fiduciary duties by, among other things, approving the sale of Avenue for an inadequate price as the result of a flawed sales process, agreeing to the inclusion of unreasonable deal protection devices in the Merger Agreement, approving the Avenue Merger in order to receive benefits not equally shared by all other shareholders of Avenue, and issuing materially misleading and incomplete disclosures to Avenue's shareholders. The lawsuit also alleges claims against Avenue and Pinnacle for aiding and abetting the individual defendants' breaches of fiduciary duties.

The plaintiff purports to seek class-wide relief, including but not limited to: monetary damages, and an award of interest, attorney's fees, and expenses. On May 18, 2016, the Bushansky litigation was transferred to the Davidson County, Tennessee Business Court Pilot Project (Business Court).

To avoid the costs, risks and uncertainties inherent in litigation, on June 10, 2016, the defendants entered into a memorandum of understanding with the plaintiff regarding settlement of the Bushansky litigation (the "memorandum of understanding"). The memorandum of understanding outlines the terms of the parties' agreement in principle to settle and release all claims which were or could have been asserted in the Bushansky action. In consideration for the settlement of the Bushansky litigation and release of claims contemplated thereby, the parties to the action agreed that Avenue and Pinnacle would make certain supplemental disclosures to the definitive proxy statement/prospectus. The memorandum of understanding contemplates that the parties will attempt in good faith to agree promptly upon a stipulation of settlement to be submitted to the Business Court for approval at the earliest practicable time. The stipulation of settlement will be subject to approval by the Business Court, which will consider the fairness, reasonableness and adequacy of such settlement. Under the terms of the proposed settlement, following final approval by the Business Court, the action will be dismissed with prejudice. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the Business Court will approve the settlement even if the parties were to enter into such stipulation. In such event, the proposed settlement will be null and void and of no force and effect.

Pinnacle Financial believes the claims asserted in the Bushansky action are without merit and intends to continue to defend the litigation. At this time though, it is not possible to predict the outcome of the proceeding or its impact on Pinnacle Financial.

### ITEM 1A. RISK FACTORS

Investing in our common stock involves various risks which are particular to our company, our industry and our market area. These matters could cause the trading price of our common stock to decline in future periods. We believe all significant risks to investors in Pinnacle Financial have been outlined in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. However, other risks may prove to be important in the future, and new risks may emerge at any time. We cannot predict with certainty all potential developments which could materially affect our financial performance or condition. There has been no material change to our risk factors as previously disclosed in the above described Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table discloses shares of our common stock repurchases during the three months ended June 30, 2016.

| Period | Total Number of Shares Repurchased [1] | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| April 1, 2016 to April 30, 2016 | 620 | $ 50.17 | - | - |
| May 1, 2016 to May 31, 2016 | 3,107 | 48.17 | - | - |
| June 1, 2016 to June 30, 2016 | 122 | 49.66 | - | - |
| Total | 3,849 | $ 48.51 | - | - |

(1) During the quarter ended June 30, 2016, 13,745 shares of restricted stock previously awarded to certain of our associates vested. We withheld 3,849 shares to satisfy tax withholding requirements associated with the vesting of these restricted shares.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
Not applicable

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable

ITEM 5. OTHER INFORMATION
None
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ITEM 6. EXHIBITS

| | |
|---|---|
| 2.1 | Agreement and Plan of Merger by and between Pinnacle Financial Partners, Inc. and Avenue Financial Holdings, Inc., dated as of January 28, 2016 (schedules and exhibits omitted pursuant to Item 601(b)(2) of Regulations S-K will be furnished supplementally to the Securities and Exchange Commission upon request) (incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 29, 2016). |
| 4.1 | Form of Certificate for Avenue Financial Holdings, Inc. Fixed/Floating Rate Subordinated Note due December 29, 2024 (incorporated by reference to the Registrant's Current Report on Form 8-K filed on July 7, 2016) |
| 10.1 | Employment Agreement, effective July 1, 2016, by and among Pinnacle Financial Partners, Inc. and Ronald L. Samuels (incorporated by reference to the Registrant's Current Report on Form 8-K filed on July 7, 2016) |
| 10.2 | Form of Pinnacle Financial Partners, Inc. 2016 Restricted Stock Award Agreement (incorporated by reference to the Registrant's Current Report on Form 8-K filed on July 7, 2016) |
| 10.3 | Supplemental Executive Retirement Plan Agreement between Avenue Bank and Ronald Samuels, dated October 26, 2007 (incorporated by reference to the Registrant's Current Report on Form 8-K filed on July 7, 2016) |
| 31.1 | Certification pursuant to Rule 13a-14(a)/15d-14(a) |
| 31.2 | Certification pursuant to Rule 13a-14(a)/15d-14(a) |
| 32.1 | Certification pursuant to 18 USC Section 1350 – Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification pursuant to 18 USC Section 1350 – Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Schema Document |
| 101.CAL | XBRL Calculation Linkbase Document |
| 101.LAB | XBRL Label Linkbase Document |
| 101.PRE | XBRL Presentation Linkbase Document |
| 101.DEF | XBRL Definition Linkbase Document |

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SIGNATURES

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

PINNACLE FINANCIAL PARTNERS, INC.

| | |
|---|---|
| August 5, 2016 | /s/ M. Terry Turner<br>M. Terry Turner<br>President and Chief Executive Officer |
| August 5, 2016 | /s/ Harold R. Carpenter<br>Harold R. Carpenter<br>Chief Financial Officer |