PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
May 02, 2014
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d)
OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the transition period from ____ to ____
Commission File Number: 000-31225

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

Tennessee	62-1812853
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
150 Third Avenue South, Suite 900, Nashville, Tennessee	37201
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o
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 x No o
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 x	Accelerated Filer o
Non-accelerated Filer o (do not check if you are a smaller reporting company)	Smaller reporting companyo

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
As of May 1, 2014 there were 35,567,991shares of common stock, $1.00 par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
March 31, 2014

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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," "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 to grow its 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 and the Knoxville 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) the development of any new market other than Nashville or Knoxville; (xii) a merger or acquisition; (xiii) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including intangible assets; (xiv) the ability to attract additional financial advisors or 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) approval of the declaration of any dividend by Pinnacle Financial's board of directors and, (xix) changes in state and federal legislation, regulations or policies applicable to banks and other financial service providers, including regulatory or legislative developments arising out of current unsettled conditions in the economy, including implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. A more detailed description of these and other risks is contained in Pinnacle Financial's most recent annual report on Form 10-K filed with the Securities and Exchange Commission on February 25, 2014. 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 release, whether as a result of new information, future events or otherwise.

Item 1. Part I. Financial Information

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

	March 31, 2014	December 31, 2013
ASSETS		
Cash and noninterest-bearing due from banks	$94,172,230	$79,785,004
Interest-bearing due from banks	75,826,385	124,509,486
Federal funds sold and other	938,792	4,644,247
Cash and cash equivalents	170,937,407	208,938,737
Securities available-for-sale, at fair value	735,400,911	693,456,314
Securities held-to-maturity (fair value of $38,194,567 and $38,817,467 at March 31, 2014 and December 31, 2013, respectively)	38,733,099	39,795,649
Mortgage loans held-for-sale	13,970,926	12,850,339
Loans	4,181,686,799	4,144,493,486
Less allowance for loan losses	(67,523,575)	(67,969,693)
Loans, net	4,114,163,224	4,076,523,793
Premises and equipment, net	71,627,370	72,649,574
Other investments	33,358,506	33,226,195
Accrued interest receivable	17,219,090	15,406,389
Goodwill	243,568,203	243,651,006
Core deposits and other intangible assets	3,603,074	3,840,750
Other real estate owned	15,037,823	15,226,136
Other assets	143,312,957	148,210,975
Total assets	$5,600,932,590	$5,563,775,857
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$1,180,202,107	$1,167,414,487
Interest-bearing	912,387,013	884,294,802
Savings and money market accounts	1,902,452,916	1,962,714,398
Time	505,534,750	519,049,037
Total deposits	4,500,576,786	4,533,472,724
Securities sold under agreements to repurchase	68,092,650	70,465,326
Federal Home Loan Bank advances	150,604,286	90,637,328
Subordinated debt and other borrowings	98,033,292	98,658,292
Accrued interest payable	745,180	792,703
Other liabilities	40,383,743	46,041,823
Total liabilities	4,858,435,937	4,840,068,196
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; 35,567,268 and 35,221,941 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	35,567,268	35,221,941

Additional paid-in capital	551,461,564	550,212,135
Retained earnings	155,840,829	142,298,199
Accumulated other comprehensive loss, net of taxes	(373,008)	(4,024,614)
Total stockholders' equity	742,496,653	723,707,661
Total liabilities and stockholders' equity	$5,600,932,590	$5,563,775,857

See accompanying notes to consolidated financial statements (unaudited).

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

	Three Months Ended March 31, 2014	2013
Interest income:		
Loans, including fees	$43,695,658	$41,514,213
Securities:		
Taxable	3,720,279	3,670,934
Tax-exempt	1,597,797	1,656,408
Federal funds sold and other	277,058	314,772
Total interest income	49,290,792	47,156,327
Interest expense:		
Deposits	2,595,240	3,412,396
Securities sold under agreements to repurchase	30,515	77,816
Federal Home Loan Bank advances and other borrowings	757,222	907,641
Total interest expense	3,382,977	4,397,853
Net interest income	45,907,815	42,758,474
Provision for loan losses	487,638	2,172,404
Net interest income after provision for loan losses	45,420,177	40,586,070
Noninterest income:		
Service charges on deposit accounts	2,790,968	2,480,244
Investment services	2,127,834	1,792,640
Insurance sales commissions	1,384,921	1,393,304
Gain on mortgage loans sold, net	952,222	1,813,488
Trust fees	1,145,751	944,332
Other noninterest income	4,334,360	3,478,348
Total noninterest income	12,736,056	11,902,356
Noninterest expense:		
Salaries and employee benefits	21,749,960	19,572,356
Equipment and occupancy	5,709,030	5,113,050
Other real estate expense	651,152	720,962
Marketing and other business development	908,901	790,671
Postage and supplies	560,614	591,488
Amortization of intangibles	237,675	520,987
Other noninterest expense	3,832,221	5,130,495
Total noninterest expense	33,649,553	32,440,009
Income before income taxes	24,506,680	20,048,417
Income tax expense	8,139,557	6,600,292
Net income	$16,367,123	$13,448,125
Per share information:		
Basic net income per common share	$0.47	$0.40
Diluted net income per common share	$0.47	$0.39
Weighted average shares outstanding:		
Basic	34,602,337	33,987,265
Diluted	34,966,600	34,206,202

See accompanying notes to consolidated financial statements (unaudited).

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

	Three Months Ended March 31,	
	2014	2013
Net income	$16,367,123	$13,448,125
Other comprehensive income (loss), net of tax:		
Change in fair value on available-for-sale securities, net of tax	4,945,912	(2,270,910)
Change in fair value of cash flow hedges, net of tax	(1,294,306)	-
Total comprehensive income	$20,018,729	$11,177,215

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 Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comp. Income (Loss), net	Total Stockholders' Equity
Balances, December 31, 2012	34,696,597	$34,696,597	$543,760,439	$87,386,689	$13,227,634	$679,071,359
Exercise of employee common stock options and related tax benefits	88,845	88,845	902,533	-	-	991,378
Issuance of restricted common shares, net of forfeitures	274,545	274,545	(274,545)	-	-	-
Restricted shares withheld for taxes	(37,500)	(37,500)	(731,679)	-	-	(769,179)
Compensation expense for restricted shares	-	-	950,498	-	-	950,498
Compensation expense for stock options	-	-	12,471	-	-	12,471
Net income	-	-	-	13,448,125	-	13,448,125
Other comprehensive loss	-	-	-	-	(2,270,910)	(2,270,910)
Balances, March 31, 2013	35,022,487	$35,022,487	$544,619,717	$100,834,814	$10,956,724	$691,433,742
Balances, December 31, 2013	35,221,941	$35,221,941	$550,212,135	$142,298,199	$(4,024,614)	$723,707,661
Exercise of employee common stock options and related tax benefits	136,482	136,482	1,981,567	-	-	2,118,049
Common dividends paid	-	-	-	(2,824,493)		(2,824,493)
Issuance of restricted common shares, net of forfeitures	260,937	260,937	(260,937)	-	-	-
Restricted shares withheld for taxes	(52,092)	(52,092)	(1,672,312)	-	-	(1,724,404)
Compensation expense for restricted shares	-	-	1,201,111	-	-	1,201,111
Net income	-	-	-	16,367,123	-	16,367,123
Other comprehensive income	-	-	-	-	3,651,606	3,651,606
Balances, March 31, 2014	35,567,268	$35,567,268	$551,461,564	$155,840,829	$(373,008)	$742,496,653

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

	Three Months Ended March 31, 2014	2013
Operating activities:		
Net income	$16,367,123	$13,448,125
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization/accretion of premium/discount on securities	957,133	988,811
Depreciation and amortization	2,258,990	2,432,535
Provision for loan losses	487,638	2,172,404
Gain on mortgage loans sold, net	(952,222)	(1,813,488)
Stock-based compensation expense	1,201,111	962,969
Deferred tax expense	(16,406)	(698,661)
Losses on dispositions of other real estate and other investments	13,112	(866,306)
Excess tax benefit from stock compensation	(1,099,570)	(28,628)
Mortgage loans held for sale:		
Loans originated	(61,458,365)	(107,845,659)
Loans sold	61,290,000	120,569,000
Decrease in other assets	527,594	3,050,703
Decrease in other liabilities	(6,576,105)	(8,339,670)
Net cash provided by operating activities	13,000,033	24,032,135
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(57,753,116)	(65,204,465)
Sales	-	-
Maturities, prepayments and calls	23,192,675	43,551,916
Activities in securities held-to-maturity:		
Purchases	-	-
Maturities, prepayments and calls	860,000	75,868
Increase in loans, net	(40,306,647)	(63,167,119)
Purchases of software, premises and equipment	(604,626)	(1,442,076)
Purchase of bank owned life insurance	-	(30,000,000)
Decrease in other investments	(2,216)	(303,750)
Net cash used in investing activities	(74,613,930)	(116,489,626)
Financing activities:		
Net decrease in deposits	(32,895,938)	(112,293,132)
Net (decrease) increase in securities sold under agreements to repurchase	(2,372,676)	14,432,033
Advances from Federal Home Loan Bank:		
Issuances	175,000,000	240,000,000
Payments/maturities	(115,016,116)	(115,036,641)
Decrease in other borrowings	(625,000)	(625,000)
Exercise of common stock options and stock appreciation rights, net of repurchase of restricted shares	1,247,220	222,200
Excess tax benefit from stock compensation	1,099,570	28,628
Common stock dividends paid	(2,824,493)	-
Net cash provided by financing activities	23,612,567	26,728,088

Net decrease in cash and cash equivalents	(38,001,330)	(65,729,403)
Cash and cash equivalents, beginning of period	208,938,737	165,288,669
Cash and cash equivalents, end of period	$170,937,407	$99,559,266

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 Bank provides a full range of banking services in its primary market areas of the Nashville-Davidson-Murfreesboro-Franklin, Tennessee and Knoxville, Tennessee 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 2013 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, any potential impairment of intangible assets, including goodwill and the valuation of deferred tax assets, other real estate owned, 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, 2013. 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, 2013.

Cash Flow Information — Supplemental cash flow information addressing certain cash and noncash transactions for each of the three months ended March 31, 2014 and 2013 was as follows:

	For the three months ended March 31,	
	2014	2013
Cash Transactions:		
Interest paid	$3,447,425	$4,540,692
Income taxes paid, net	6,100,000	7,100,000
Noncash Transactions:		
Loans charged-off to the allowance for loan losses	1,503,511	3,557,313
Loans foreclosed upon and transferred to other real estate owned	1,645,100	550,000
Available-for-sale securities transferred to held-to-maturity portfolio	-	39,959,647

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Income Per Common Share — Basic net income per common share available to common stockholders (EPS) is computed by dividing net income available to common stockholders 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 months ended March 31, 2014 and 2013:

	For the three months ended March 31,	
	2014	2013
Basic net income per share calculation:		
Numerator - Net income available to common stockholders	$16,367,123	$13,448,125
Denominator - Average common shares outstanding	34,602,337	33,987,265
Basic net income per share available to common stockholders	$0.47	$0.40
Diluted net income per share calculation:		
Numerator – Net income available to common stockholders	$16,367,123	$13,448,125
Denominator - Average common shares outstanding	34,602,337	33,987,265
Dilutive shares contingently issuable	364,263	218,937
Average diluted common shares outstanding	34,966,600	34,206,202
Diluted net income per share available to common stockholders	$0.47	$0.39

Note 2. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at March 31, 2014 and December 31, 2013 are summarized as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2014:				
Securities available-for-sale:				
U.S. Treasury securities	$ -	$ -	$ -	$ -
U.S. government agency securities	116,830	19	9,481	107,368
Mortgage-backed securities	448,646	9,835	6,286	452,195
State and municipal securities	142,338	6,931	496	148,773
Asset-backed securities	16,048	-	226	15,822
Corporate notes and other	10,214	1,031	2	11,243
	$ 734,076	$ 17,816	$ 16,491	$ 735,401
Securities held-to-maturity:				
State and municipal securities	$ 38,733	$ 103	$ 641	$ 38,195
	$ 38,733	$ 103	$ 641	$ 38,195

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2013:				
Securities available-for-sale:				
U.S. Treasury securities	$ -	$ -	$ -	$ -
U.S. government agency securities	117,282	13	13,422	103,873
Mortgage-backed securities	411,967	9,771	8,802	412,936
State and municipal securities	143,763	5,504	856	148,411
Asset-backed securities	17,262	-	255	17,007
Corporate notes and other	10,218	1,018	7	11,229
	$ 700,492	$ 16,306	23,342	$ 693,456
Securities held-to-maturity:				
State and municipal securities	$ 39,796	$ 72	$ 1,051	$ 38,817
	$ 39,796	$ 72	$ 1,051	$ 38,817

At March 31, 2014, approximately $621,400.0 million of securities within Pinnacle Financial's investment portfolio were either pledged to secure public funds and other deposits or securities sold under agreements to repurchase.

During 2013, approximately $40.0 million of available-for-sale securities were transferred to the held-to-maturity portfolio. The transfers of debt securities into the held-to-maturity category from the available-for-sale category were made at fair value at the date of transfer. The unrealized holding gain or loss at the date of transfer was retained in other comprehensive income and in the carrying value of the held-to-maturity securities. Such amounts will be amortized to interest income over the remaining life of the securities.

The amortized cost and fair value of debt securities as of March 31, 2014 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage- and asset-backed securities since the mortgages and assets underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary (in thousands):

	Available-for-sale		Held-to-maturity	
March 31, 2014:	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 5,218	$ 5,276	$ 239	$ 241
Due in one year to five years	28,662	29,690	11,556	11,581
Due in five years to ten years	130,249	131,868	14,699	14,398
Due after ten years	105,253	100,550	12,239	11,975
Mortgage-backed securities	448,646	452,195	-	-
Asset-backed securities	16,048	15,822	-	-
	$ 734,076	$ 735,401	$ 38,733	$ 38,195

At March 31, 2014 and December 31, 2013, the following investments had unrealized losses. The table below classifies these investments according to the term of the unrealized losses of less than twelve months or twelve months or longer (in thousands):

	Investments with an Unrealized Loss of less than 12 months		Investments with an Unrealized Loss of 12 months or longer		Total Investments with an Unrealized Loss	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At March 31, 2014:						
U.S. Treasury securities	$-	$ -	$-	$ -	$-	$ -
U.S. government agency securities	4,910	14	96,804	9,467	101,714	9,481
Mortgage-backed securities	133,216	1,172	92,296	5,114	225,512	6,286
State and municipal securities	26,778	670	9,630	467	36,408	1,137
Asset-backed securities	-	-	15,823	226	15,823	226
Corporate notes	749	1	158	1	907	2
Total temporarily-impaired securities	$165,653	$ 1,857	$214,711	$ 15,275	$380,364	$ 17,132
At December 31, 2013:						
U.S. Treasury securities	$-	$ -	$-	$ -	$-	$ -
U.S. government agency securities	8,742	22	92,869	13,400	101,611	13,422
Mortgage-backed securities	157,262	3,913	42,903	4,889	200,165	8,802
State and municipal securities	46,282	1,351	3,798	555	50,080	1,906
Asset-backed securities	-	-	17,006	255	17,006	255
Corporate notes	946	6	159	2	1,105	8
Total temporarily-impaired securities	$213,232	$ 5,292	$156,735	$ 19,101	$369,967	$ 24,393

The applicable dates for determining when securities are in an unrealized loss position are March 31, 2014 and December 31, 2013. As such, it is possible that a security had a market value that exceeded its amortized cost on other days during the past twelve-month periods ended March 31, 2014 and December 31, 2013, but is in the "Investments with an Unrealized Loss of less than 12 months" category above.

As shown in the tables above, at March 31, 2014, Pinnacle Financial had approximately $17.1 million in unrealized losses on $380.4 million of securities. The unrealized losses associated with these investment securities are driven by changes in interest rates and the unrealized loss is recorded as a component of equity. These securities will continue to be monitored as a part of our ongoing impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond issuers. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. If a shortfall in future cash flows is identified, a credit loss will be deemed to have occurred and will be recognized as a charge to earnings and a new cost basis for the security will be established.

Because Pinnacle Financial currently does not intend to sell those securities that have an unrealized loss at March 31, 2014, and it is not more-likely-than-not that Pinnacle Financial will be required to sell the securities before recovery of their amortized cost bases, which may be maturity, Pinnacle Financial does not consider these securities to be other-than-temporarily impaired at March 31, 2014.

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. There is also 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 3. 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).

Commercial loans receive risk ratings by the assigned financial advisor subject to validation by Pinnacle Financial's independent loan review department. Risk ratings are categorized as pass, special mention, substandard, substandard-nonaccrual or doubtful-nonaccrual. Pinnacle Financial believes that its categories follow those used by Pinnacle Bank's primary regulators. At March 31, 2014, approximately 74% of our loan portfolio was analyzed as a commercial loan type with a specifically assigned risk rating in the allowance for loan loss assessment. Consumer loans and small business loans are generally not assigned an individual risk rating but are evaluated as either accrual or nonaccrual based on the performance of the individual loans. However, certain consumer real estate-mortgage loans and certain consumer and other loans receive a specific risk rating due to the loan proceeds being used for commercial purposes even though the collateral may be of a consumer loan nature.

Risk ratings are subject to continual review by the loan officer. At least annually, our credit procedures require that every risk rated loan of $250,000 or more be subject to a formal credit risk review process. Each loan's risk rating is also subject to review by our independent loan review department, which reviews a substantial portion of our risk rated portfolio annually. Included in the coverage are independent loan reviews of loans in targeted higher-risk portfolio segments.

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

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

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

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

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

The following table outlines the amount of each loan classification categorized into each risk rating category as of March 31, 2014 and December 31, 2013 (in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Total
March 31, 2014						
Accruing loans						
Pass	$ 1,410,425	$ 676,486	$ 252,406	$ 1,515,110	$ 158,088	$ 4,012,515
Special Mention	7,997	3,557	30,083	12,814	149	54,600
Substandard [1]	22,726	13,900	10,465	36,614	154	83,859
Total	1,441,148	693,943	292,954	1,564,538	158,391	4,150,974
Impaired loans						
Nonaccrual loans						
Substandard-nonaccrual	7,145	5,679	990	1,538	254	15,606
Doubtful-nonaccrual	-	-	-	-	-	-
Total nonaccrual loans	7,145	5,679	990	1,538	254	15,606
Troubled debt restructurings[2]						
Pass	143	1,657	111	277	286	2,474
Special Mention	7,736	2,313	-	2,584	-	12,633
Substandard	-	-	-	-	-	-
Total troubled debt restructurings	7,879	3,970	111	2,861	286	15,107
Total impaired loans	15,024	9,649	1,101	4,399	540	30,713
Total loans	$ 1,456,172	$ 703,592	$ 294,055	$ 1,568,937	$ 158,931	$ 4,181,687

(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 substandard nonaccrual loans and substandard troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately $83.9 million at March 31, 2014, compared to $65.0 million at December 31, 2013.

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

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Total
December 31, 2013						
Accruing loans						
Pass	$ 1,332,387	$ 670,412	$ 275,876	$ 1,557,923	$ 143,032	$ 3,979,630
Special Mention	8,282	1,824	31,835	20,065	-	62,006
Substandard (1)	20,296	14,107	7,297	23,174	154	65,028
Total	1,360,965	686,343	315,008	1,601,162	143,186	4,106,664
Impaired loans						
Nonaccrual loans						
Substandard-nonaccrual	9,017	5,289	1,070	2,565	242	18,183
Doubtful-nonaccrual	-	-	-	-	-	-
Total nonaccrual loans	9,017	5,289	1,070	2,565	242	18,183
Troubled debt restructurings(2)						
Pass	2,564	1,666	113	320	276	4,939
Special Mention	-	-	-	-	-	-
Substandard	10,889	2,318				