

HAWTHORN BANCSHARES, INC.

Form 10-Q

November 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2016

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number: **0-23636**

HAWTHORN BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Missouri

43-1626350

(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

132 East High Street, Box 688, Jefferson City, Missouri 65102

(Address of principal executive offices)

(Zip Code)

(573) 761-6100

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). **x** 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer "

Accelerated filer "

Non-accelerated filer **x** (Do not check if 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 **x** No

As of November 09, 2016, the registrant had 5,624,310 shares of common stock, par value \$1.00 per share, outstanding

Part I - Financial Information**Item 1. Financial Statements****HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES****Consolidated Balance Sheets (unaudited)**

	September 30, 2016	December 31, 2015
<i>(In thousands, except per share data)</i>		
ASSETS		
Cash and due from banks	\$ 19,106	\$ 20,484
Federal funds sold and other overnight interest-bearing deposits	19,788	7,893
Cash and cash equivalents	38,894	28,377
Investment in available-for-sale securities, at fair value	221,824	235,054
Other investments and securities, at cost	9,240	8,037
Total investment securities	231,064	243,091
Loans	947,771	865,080
Allowances for loan losses	(9,470)	(8,604)
Net loans	938,301	856,476
Premises and equipment - net	35,591	36,389
Mortgage servicing rights	2,370	2,847
Other real estate and repossessed assets - net	14,438	15,992
Accrued interest receivable	4,624	4,853
Cash surrender value - life insurance	2,396	2,348
Other assets	10,041	10,548
Total assets	\$ 1,277,719	\$ 1,200,921
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Non-interest bearing demand	\$ 229,987	\$ 208,035
Savings, interest checking and money market	477,945	441,080
Time deposits \$100,000 and over	153,651	132,244
Other time deposits	156,448	165,838
Total deposits	1,018,031	947,197
Federal funds purchased and securities sold under agreements to repurchase	28,504	56,834
Subordinated notes	49,486	49,486
Federal Home Loan Bank advances	79,000	50,000
Accrued interest payable	408	382
Other liabilities	9,502	9,736
Total liabilities	1,184,931	1,113,635
Stockholders' equity:		
	5,822	5,605

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Common stock, \$1 par value, authorized 15,000,000 shares; issued 5,822,357 and 5,605,202 shares, respectively

Surplus	41,497		38,549	
Retained earnings	50,021		48,700	
Accumulated other comprehensive loss, net of tax	(567	)	(2,018)
Treasury stock; 194,045 and 164,013 shares, at cost	(3,985	)	(3,550)
Total stockholders' equity	92,788		87,286	
Total liabilities and stockholders' equity	\$ 1,277,719		\$ 1,200,921	

See accompanying notes to the consolidated financial statements (*unaudited*).

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**Consolidated Statements of Income** *(unaudited)*

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2016	2015	2016	2015
INTEREST INCOME				
Interest and fees on loans	\$ 10,634	\$ 10,713	\$ 30,929	\$ 30,891
Interest on investment securities:				
Taxable	754	872	2,523	2,663
Nontaxable	119	169	381	524
Federal funds sold and other overnight interest-bearing deposits	19	3	69	24
Dividends on other securities	80	72	231	139
Total interest income	11,606	11,829	34,133	34,241
INTEREST EXPENSE				
Interest on deposits:				
Savings, interest checking and money market	291	241	874	738
Time deposit accounts \$100,000 and over	267	222	708	653
Other time deposits	231	269	707	831
Interest on federal funds purchased and securities sold under agreements to repurchase	13	12	51	28
Interest on subordinated notes	375	325	1,095	958
Interest on Federal Home Loan Bank advances	282	202	732	513
Total interest expense	1,459	1,271	4,167	3,721
Net interest income	10,147	10,558	29,966	30,520
Provision for loan losses	300	0	975	250
Net interest income after provision for loan losses	9,847	10,558	28,991	30,270
NON-INTEREST INCOME				
Service charges and other fees	882	903	2,544	2,597
Bank card income and fees	593	632	1,875	1,849
Trust department income	216	235	699	714
Real estate servicing fees, net	(4)	177	(36)	357
Gain on sale of mortgage loans, net	266	322	653	1,103
Gain on sale of investment securities	111	0	602	8
Other	61	67	185	157
Total non-interest income	2,125	2,336	6,522	6,785
NON-INTEREST EXPENSE				
Salaries and employee benefits	5,063	5,320	15,718	15,798
Occupancy expense, net	730	685	2,037	2,064
Furniture and equipment expense	438	464	1,288	1,379
Processing, network, and bank card expense	878	806	2,490	2,402
Legal, examination, and professional fees	277	332	939	943
FDIC insurance assessment	196	175	560	673

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Advertising and promotion	283	273	734	780
Postage, printing, and supplies	244	250	771	794
Real estate foreclosure expense (gains), net	49	(329)	232	(352)
Other	927	1,001	2,753	2,472
Total non-interest expense	9,085	8,977	27,522	26,953
Income before income taxes	2,887	3,917	7,991	10,102
Income tax expense	1,003	1,378	2,697	3,497
Net income	1,884	2,539	5,294	6,605
Basic earnings per share	\$ 0.33	\$ 0.45	\$ 0.94	\$ 1.17
Diluted earnings per share	\$ 0.33	\$ 0.45	\$ 0.94	\$ 1.17

See accompanying notes to the consolidated financial statements (*unaudited*).

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income *(unaudited)*

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	\$ 1,884	\$ 2,539	\$ 5,294	\$ 6,605
Other comprehensive income (loss), net of tax				
Investment securities available-for-sale:				
Unrealized gain (loss) on investment securities available-for-sale, net of tax	(294)	993	1,788	627
Adjustment for gain on sale of investment securities, net of tax	(69)	0	(373)	(5)
Defined benefit pension plans:				
Amortization of prior service cost included in net periodic pension cost, net of tax	12	24	36	68
Total other comprehensive income (loss)	(351)	1,017	1,451	690
Total comprehensive income	\$ 1,533	\$ 3,556	\$ 6,745	\$ 7,295

See accompanying notes to the consolidated financial statements *(unaudited)*.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**Consolidated Statements of Stockholders' Equity** *(unaudited)*

	Accumulated Other Comprehensive Income				Treasury	Total Stock - holders'	
(In thousands)	Common Stock	Surplus	Retained Earnings	(Loss)	Stock	Equity	
Balance, December 31, 2014	\$ 5,396	\$35,901	\$ 44,016	\$ (1,228	) \$ (3,517	) \$80,568
Net income	0	0	6,605	0	0	6,605	
Other comprehensive income	0	0	0	690	0	690	
Stock dividend	209	2,638	(2,847	) 0	0	0
Stock based compensation expense	0	5	0	0	0	5	
Cash dividends declared, common stock	0	0	(795) 0	0	(795)
Balance, September 30, 2015	\$ 5,605	\$38,544	\$ 46,979	\$ (538	) \$ (3,517	) \$87,073
Balance, December 31, 2015	\$ 5,605	\$38,549	\$ 48,700	\$ (2,018	) \$ (3,550	) \$87,286
Net income	0	0	5,294	0	0	5,294	
Other comprehensive income	0	0	0	1,451	0	1,451	
Stock dividend	217	2,932	(3,149	) 0	0	0
Stock based compensation expense	0	16	0	0	0	16	
Purchases of treasury stock	0	0	0	0	(435) (435)
Cash dividends declared, common stock	0	0	(824) 0	0	(824)
Balance, September 30, 2016	\$ 5,822	\$41,497	\$ 50,021	\$ (567	) \$ (3,985	) \$92,788

See accompanying notes to the consolidated financial statements *(unaudited)*.

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES**Consolidated Statements of Cash Flows** *(unaudited)*

	Nine Months Ended September	
	30,	
(In thousands)	2016	2015
Cash flows from operating activities:		
Net income	\$ 5,294	\$ 6,605
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	975	250
Depreciation expense	1,432	1,454
Net amortization of investment securities, premiums, and discounts	1,418	1,007
Stock based compensation expense	16	5
Change in fair value of mortgage servicing rights	690	291
Gain on sale of investment securities	(602)	(8)
Gain on sales and dispositions of premises and equipment	(9)	(8)
Gain on sales and dispositions of other real estate and repossessed assets	(215)	(151)
Provision for other real estate owned	176	(6)
Decrease (increase) in accrued interest receivable	229	(93)
Increase in cash surrender value -life insurance	(48)	(45)
(Increase) decrease in other assets	(135)	2,224
Increase in accrued interest payable	26	5
(Decrease) increase in other liabilities	(243)	1,251
Origination of mortgage loans for sale	(27,849)	(40,008)
Proceeds from the sale of mortgage loans	28,769	40,090
Gain on sale of mortgage loans, net	(653)	(1,103)
Other, net	(155)	(194)
Net cash provided by operating activities	9,116	11,566
Cash flows from investing activities:		
Net increase in loans	(85,087)	(21,892)
Purchase of available-for-sale debt securities	(102,000)	(81,595)
Proceeds from maturities of available-for-sale debt securities	42,441	24,188
Proceeds from calls of available-for-sale debt securities	13,535	11,440
Proceeds from sales of available-for-sale debt securities	60,720	720
Proceeds from sales of FHLB stock	0	400
Purchases of FHLB stock	(1,203)	(4,915)
Purchases of premises and equipment	(881)	(709)
Proceeds from sales of premises and equipment	9	11
Proceeds from sales of other real estate and foreclosed assets	3,613	1,443
Net cash used in investing activities	(68,853)	(70,909)
Cash flows from financing activities:		
Net increase in demand deposits	21,952	2,014
Net increase in interest-bearing transaction accounts	36,865	10,819
Net increase (decrease) in time deposits	12,017	(10,179)

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Net (decrease) increase in federal funds purchased and securities sold under agreements to repurchase	(28,330))	9,792	
Repayment of FHLB advances	(16,000)	)	(55,000))
FHLB advances	45,000		92,000	
Purchases of treasury stock	(435)	)	0	
Cash dividends paid - common stock	(815)	)	(785))
Net cash provided by financing activities	70,254		48,661	
Net increase (decrease) in cash and cash equivalents	10,517		(10,682))
Cash and cash equivalents, beginning of period	28,377		42,809	
Cash and cash equivalents, end of period	\$ 38,894		\$ 32,127	

See accompanying notes to the consolidated financial statements (*unaudited*).

HAWTHORN BANCSHARES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (continued) *(unaudited)*

(In thousands)	Nine Months Ended	September 30,
	2016	2015
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$ 4,141	\$ 3,717
Income taxes	\$ 2,705	\$ 1,559
Noncash investing activities:		
Other real estate and repossessed assets acquired in settlement of loans	\$ 2,020	\$ 4,549

See accompanying notes to the consolidated financial statements *(unaudited)*.

Hawthorn Bancshares, Inc.
and subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

(1) Summary of Significant Accounting Policies

Hawthorn Bancshares, Inc. (the Company) through its subsidiary, Hawthorn Bank (the Bank), provides a broad range of banking services to individual and corporate customers located within the communities in and surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, Branson, and the greater Kansas City metropolitan area. The Company is subject to competition from other financial and nonfinancial institutions providing financial products. Additionally, the Company and its subsidiaries are subject to the regulations of certain regulatory agencies and undergo periodic examinations by those regulatory agencies.

The accompanying unaudited consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q, and Rule 10-01 of Regulation S-X. Accordingly, the unaudited consolidated financial statements do not include all of the information and disclosures required by U.S. GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. Certain amounts in the 2015 condensed consolidated financial statements have been reclassified to conform to the 2016 condensed consolidated presentation. Such reclassifications have no effect on previously reported net income or stockholders' equity.

The preparation of the consolidated financial statements includes all adjustments that, in the opinion of management, are necessary in order to make those statements not misleading. Management is required to make estimates and assumptions, including the determination of the allowance for loan losses, real estate acquired in connection with foreclosure or in satisfaction of loans, and fair values of investment securities available-for-sale that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's management has evaluated and did not identify any subsequent events or transactions requiring recognition or disclosure in the consolidated financial statements.

Stock Dividend On July 1, 2016, the Company paid a special stock dividend of four percent to shareholders of record at the close of business on June 15, 2016. For all periods presented, share information, including basic and diluted earnings per share, has been adjusted retroactively to reflect this change.

The following represents significant new accounting principles adopted in 2016:

Consolidation The FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*, in February 2015. The amendment substantially changes the way reporting entities are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the new amendment. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, eliminate the presumption that a general partner should consolidate a limited partnership, and affect the consolidation analysis of reporting entities that are involved with VIEs. The amendments were effective for interim and annual periods beginning January 1, 2016. The adoption did not have a significant effect on the Company's consolidated financial statements.

Intangible Assets The FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, in April 2015. The amendments provide guidance to customers about whether a cloud computing arrangement includes a software license. Arrangements containing a license should be recorded as consistent with the acquisition of software licenses, whereas arrangements that do not include a software license should be recorded as consistent with the accounting for service contracts. These amendments were effective for interim and annual periods beginning January 1, 2016. The adoption did not have a significant effect on the Company's consolidated financial statements.

Hawthorn Bancshares, Inc.
and subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

(2) Loans and Allowance for Loan Losses

Loans

A summary of loans, by major class within the Company's loan portfolio, at September 30, 2016 and December 31, 2015 is as follows:

(in thousands)	September 30, 2016	December 31, 2015
Commercial, financial, and agricultural	\$ 172,274	\$ 149,091
Real estate construction - residential	17,066	16,895
Real estate construction - commercial	48,743	33,943
Real estate mortgage - residential	256,786	256,086
Real estate mortgage - commercial	423,779	385,869
Installment and other consumer	29,123	23,196
Total loans	\$ 947,771	\$ 865,080

The Bank grants real estate, commercial, installment, and other consumer loans to customers located within the communities surrounding Jefferson City, Columbia, Clinton, Warsaw, Springfield, Branson and the greater Kansas City metropolitan area. As such, the Bank is susceptible to changes in the economic environment in these communities. The Bank does not have a concentration of credit in any one economic sector. Installment and other consumer loans consist primarily of automobile financing. At September 30, 2016, loans with a carrying value of \$472.9 million, or \$388.3 million fair value, were pledged to the Federal Home Loan Bank as collateral for borrowings and letters of credit.

Allowance for Loan Losses

The following is a summary of the allowance for loan losses during the periods indicated.

	Three Months Ended September 30, 2016							
	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Construction Commercial	Real Estate Mortgage Residential	Real Estate Mortgage Commercial	Installment Loans to Individuals	Un- allocated	Total
(in thousands)								
Balance at beginning of period	\$2,996	\$ 63	\$ 249	\$ 2,293	\$ 3,411	\$ 284	\$ 96	\$9,392
Additions:								
Provision for loan losses	(94)	(4)	44	(152)	450	50	6	300
Deductions:								
Loans charged off	157	0	0	92	27	86	0	362
Less recoveries on loans	(26)	0	0	(31)	(36)	(47)	0	(140)
Net loans charged off	131	0	0	61	(9)	39	0	222
Balance at end of period	\$2,771	\$ 59	\$ 293	\$ 2,080	\$ 3,870	\$ 295	\$ 102	\$9,470

	Nine Months Ended September 30, 2016							
	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Construction Commercial	Real Estate Mortgage Residential	Real Estate Mortgage Commercial	Installment Loans to Individuals	Un- allocated	Total
(in thousands)								
Balance at beginning of period	\$2,153	\$ 59	\$ 644	\$ 2,439	\$ 2,935	\$ 273	\$ 101	\$8,604
Additions:								
Provision for loan losses	710	0	(852)	66	944	106	1	975
Deductions:								
Loans charged off	295	0	1	474	137	209	0	1,116
Less recoveries on loans	(203)	0	(502)	(49)	(128)	(125)	0	(1,007)
Net loans charged off	92	0	(501)	425	9	84	0	109
Balance at end of period	\$2,771	\$ 59	\$ 293	\$ 2,080	\$ 3,870	\$ 295	\$ 102	\$9,470

Hawthorn Bancshares, Inc.
and subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

	Three Months Ended September 30, 2015							
	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Construction Commercial	Real Estate Mortgage Residential	Real Estate Mortgage Commercial	Installment Loans to Individuals	Un- allocated	Total
(in thousands)								
Balance at beginning of period	\$3,124	\$ 17	\$ 414	\$ 2,332	\$ 3,870	\$ 185	\$ 44	\$9,986
Additions:								
Provision for loan losses	439	(27)	137	(233)	(503)	66	121	0
Deductions:								
Loans charged off	591	0	0	87	126	80	0	884
Less recoveries on loans	(28)	(28)	0	(45)	(5)	(38)	0	(144)
Net loans charged off	563	(28)	0	42	121	42	0	740
Balance at end of period	\$3,000	\$ 18	\$ 551	\$ 2,057	\$ 3,246	\$ 209	\$ 165	\$9,246

	Nine Months Ended September 30, 2015							
	Commercial & Agricultural	Real Estate Construction Residential	Real Estate Construction Commercial	Real Estate Mortgage Residential	Real Estate Mortgage Commercial	Installment Loans to Individuals	Un- allocated	Total
(in thousands)								
Balance at beginning of period	\$1,779	\$ 171	\$ 466	\$ 2,527	\$ 3,846	\$ 270	\$ 40	\$9,099
Additions:								
Provision for loan losses	1,319	(475)	90	(277)	(598)	66	125	250
Deductions:								
Loans charged off	741	0	5	298	159	241	0	1,444
Less recoveries on loans	(643)	(322)	0	(105)	(157)	(114)	0	(1,341)
Net loans (recovered) charged off	98	(322)	5	193	2	127	0	103
Balance at end of period	\$3,000	\$ 18	\$ 551	\$ 2,057	\$ 3,246	\$ 209	\$ 165	\$9,246

Loans, or portions of loans, are charged off to the extent deemed uncollectible or a loss is confirmed. Loan charge-offs reduce the allowance for loan losses, and recoveries of loans previously charged off are added back to the allowance. If management determines that it is probable that all amounts due on a loan will not be collected under the original terms of the loan agreement, the loan is considered to be impaired. These loans are evaluated individually for impairment and specific reserves are estimated as further discussed below. Loans not individually evaluated are aggregated by risk characteristics and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type, delinquencies, current economic conditions, loan risk ratings and industry concentration.

Beginning in the first quarter of 2016, the Company began to lengthen its look-back period with the intent to increase such period from three to five years over the next two years. The Company believes that the five-year look-back period, which is consistent with the Company's practices prior to the start of the economic recession in 2008, provides a representative historical loss period in the current economic environment.

Hawthorn Bancshares, Inc.
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Notes to the Consolidated Financial Statements

(Unaudited)

The following table provides the balance in the allowance for loan losses at September 30, 2016 and December 31, 2015, and the related loan balance by impairment methodology.

	Commercial, Financial, and Agricultural	Real Estate Construction Residential	Real Estate Construction Commercial	Real Estate Mortgage Residential	Real Estate Mortgage Commercial	Installment Loans to Individuals	Un- allocated	Total
(in thousands)								
September 30, 2016								
Allowance for loan losses:								
Individually evaluated for impairment	\$ 632	\$ 0	\$ 8	\$ 386	\$ 262	\$ 14	\$ 0	\$ 1,302
Collectively evaluated for impairment	2,139	59	285	1,694	3,608	281	102	8,168
Total	\$ 2,771	\$ 59	\$ 293	\$ 2,080	\$ 3,870	\$ 295	\$ 102	\$ 9,470
Loans outstanding:								
Individually evaluated for impairment	\$ 1,811	\$ 0	\$ 51	\$ 5,195	\$ 2,068	\$ 117	\$ 0	\$ 9,242
Collectively evaluated for impairment	170,463	17,066	48,692	251,591	421,711	29,006	0	938,529
Total	\$ 172,274	\$ 17,066	\$ 48,743	\$ 256,786	\$ 423,779	\$ 29,123	\$ 0	\$ 947,771
December 31, 2015								
Allowance for loan losses:								
Individually evaluated for	\$ 285	\$ 0	\$ 15	\$ 955	\$ 266	\$ 19	\$ 0	\$ 1,540

impairment								
Collectively								
evaluated for	1,868	59	629	1,484	2,669	254	101	7,064
impairment								
Total	\$ 2,153	\$ 59	\$ 644	\$ 2,439	\$ 2,935	\$ 273	\$ 101	\$ 8,604
Loans outstanding:								
Individually								
evaluated for	\$ 1,005	\$ 0	\$ 102	\$ 5,936	\$ 3,081	\$ 144	\$ 0	\$ 10,268
impairment								
Collectively								
evaluated for	148,086	16,895	33,841	250,150	382,788	23,052	0	854,812
impairment								
Total	\$ 149,091	\$ 16,895	\$ 33,943	\$ 256,086	\$ 385,869	\$ 23,196	\$ 0	\$ 865,080

Impaired Loans

Loans evaluated under ASC 310-10-35 include loans which are individually evaluated for impairment. All other loans are collectively evaluated for impairment under ASC 450-20. Impaired loans individually evaluated for impairment totaled \$9.2 million and \$10.3 million at September 30, 2016 and December 31, 2015, respectively, and are comprised of loans on non-accrual status and loans which have been classified as troubled debt restructurings (TDRs).

The net carrying value of impaired loans is generally based on the fair values of collateral obtained through independent appraisals or internal evaluations, less selling costs, or by discounting the total expected future cash flows. At September 30, 2016 and December 31, 2015, \$4.7 million and \$6.4 million, respectively, of impaired loans were evaluated based on the fair value less estimated selling costs of the loan's collateral. Once the impairment amount is calculated a specific reserve allocation is recorded. At September 30, 2016, \$1.3 million of the Company's allowance for loan losses was allocated to impaired loans totaling \$9.2 million compared to \$1.5 million of the Company's allowance for loan losses allocated to impaired loans totaling \$10.3 million at December 31, 2015. Management determined that \$2.1 million, or 23%, of total impaired loans required no reserve allocation at September 30, 2016 compared to \$4.5 million, or 44%, at December 31, 2015 primarily due to adequate collateral values, acceptable payment history and adequate cash flow ability.

Hawthorn Bancshares, Inc.
and subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

The categories of impaired loans at September 30, 2016 and December 31, 2015 are as follows:

(in thousands)	September 30, 2016	December 31, 2015
Non-accrual loans	\$ 3,587	\$ 4,418
Performing TDRs	5,655	5,850
Total impaired loans	\$ 9,242	\$ 10,268

The following tables provide additional information about impaired loans at September 30, 2016 and December 31, 2015, respectively, segregated between loans for which an allowance has been provided and loans for which no allowance has been provided.

(in thousands)	Recorded Investment	Unpaid Principal Balance	Specific Reserves
September 30, 2016			
With no related allowance recorded:			
Commercial, financial and agricultural	\$ 787	\$ 927	\$ 0
Real estate - residential	1,345	1,346	0
Total	\$ 2,132	\$ 2,273	\$ 0
With an allowance recorded:			
Commercial, financial and agricultural	\$ 1,024	\$ 1,059	\$ 632
Real estate - construction commercial	51	56	8
Real estate - residential	3,850	3,914	386
Real estate - commercial	2,068	2,404	262
Consumer	117	147	14
Total	\$ 7,110	\$ 7,580	\$ 1,302
Total impaired loans	\$ 9,242	\$ 9,853	\$ 1,302

(in thousands)	Recorded	Unpaid	Specific
	Investment	Principal	Reserves
December 31, 2015			
With no related allowance recorded:			
Commercial, financial and agricultural	\$ 448	\$ 450	\$ 0
Real estate - residential	1,645	1,712	0
Real estate - commercial	2,446	2,572	0
Total	\$ 4,539	\$ 4,734	\$ 0
With an allowance recorded:			
Commercial, financial and agricultural	\$ 557	\$ 572	\$ 285
Real estate - construction commercial	102	115	15
Real estate - residential	4,291	4,320	955
Real estate - commercial	635	884	266
Consumer	144	182	19
Total	\$ 5,729	\$ 6,073	\$ 1,540
Total impaired loans	\$ 10,268	\$ 10,807	\$ 1,540

Hawthorn Bancshares, Inc.
and subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

The following table presents by class, information related to the average recorded investment and interest income recognized on impaired loans during the periods indicated.

(in thousands)	Three Months Ended September 30, 2016				Nine Months Ended September 30, 2015			
	Average Recorded Investment	Interest Recognized For the Period Ended	Average Recorded Investment	Interest Recognized For the Period Ended	Average Recorded Investment	Interest Recognized For the Period Ended	Average Recorded Investment	Interest Recognized For the Period Ended
With no related allowance recorded:								
Commercial, financial and agricultural	\$ 460	\$ (9)	\$ 3,416	\$ 6	\$ 491	\$ 18	\$ 4,033	\$ 33
Real estate - construction residential	0	0	0	0	0	0	1,101	0
Real estate - construction commercial	0	0	0	0	0	0	2,002	0
Real estate - residential	2,050	27	2,326	5	1,640	63	2,924	26
Real estate - commercial	1,167	17	2,958	17	1,769	17	8,978	103
Consumer	0	0	0	0	0	0	10	1
Total	\$ 3,677	\$ 35	\$ 8,700	\$ 28	\$ 3,900	\$ 98	\$ 19,048	\$ 163
With an allowance recorded:								
Commercial, financial and agricultural	\$ 1,398	\$ (13)	\$ 787	\$ 5	\$ 924	\$ 9	\$ 1,389	\$ 18
Real estate - construction residential	0	0	0	0	0	0	0	0
Real estate - construction commercial	51	0	55	0	64	0	28	0
Real estate - residential	2,992	20	4,850	30	3,741	78	4,713	80
Real estate - commercial	811	14	1,228	0	717	61	1,216	0

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Consumer	118	(1)	162	0	123	0	209	0
Total	\$ 5,370	\$	20	\$ 7,082	\$				