

PUBLIC DISCLOSURE

September 8, 2003

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Bank of Frio Canyon
Certificate Number: 21158**

**243 Evergreen Street
P.O. Box 869
Leakey, Texas 78873-0869**

Federal Deposit Insurance Corporation

**Division of Supervision and Consumer Protection
Dallas Regional Office
1910 Pacific Avenue, 19th Floor
Dallas, Texas 75201**

NOTE: This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

*This document is an evaluation of the Community Reinvestment Act (CRA) performance of **Bank of Frio Canyon** prepared by the **Federal Deposit Insurance Corporation**, the institution's supervisory agency, as of **September 8, 2003**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 345.*

INSTITUTION RATING

INSTITUTION'S CRA RATING: This institution is rated **Satisfactory**.

The FDIC assigned a Satisfactory rating at the bank's last CRA evaluation dated July 28, 1998.

Bank of Frio Canyon is a one-office \$29 million institution headquartered in Leakey, Texas. During this evaluation, examiners applied those performance factors applicable to small banks: loan-to-deposit ratio, lending inside the assessment area, lending to borrowers of different incomes and businesses of different sizes, geographic distribution of loans, and response to complaints. Since no complaints were received, this factor did not play a part in the assignment of the overall rating. Management did not request a review of investments and services. In arriving at the overall rating for this institution, the performance factors relating to the geographic distribution of loans and lending to borrowers of different incomes and businesses of different sizes was given more weight than the other factors.

This evaluation is based upon the bank's origination of small business and residential real estate loans. Both loan products received equal weight in the overall analysis. Individual conclusions for each performance factor are summarized below. Performance under each test is detailed elsewhere in this evaluation.

- The bank achieved an average loan-to-deposit ratio of 50 percent since the last CRA evaluation, demonstrating acceptable performance for this factor. Bank of Frio Canyon compares reasonably to competing institutions in the assessment area. The loan-to-deposit ratio has shown a steady increase since the last evaluation.
- A substantial majority of the bank's small business and residential real estate lending activity is centered inside the assessment area, demonstrating an excellent level of performance. Small business lending inside the assessment area represents 89 percent by number and 89 percent by dollar volume. Residential real estate lending inside the assessment area represents 99 percent by number and 97 percent by dollar volume.
- Bank of Frio Canyon has established an adequate record of lending to borrowers of different incomes and businesses of different sizes. The bank's distribution of small business loans by loan and revenue size is reasonable. Extensions of credit to residential real estate borrowers reflect an adequate level of performance, given the ability of lower-income borrowers to qualify for these higher dollar loans.
- The bank has reasonably distributed small business and residential loans throughout its assessment area geographies, given the office location and banking competition.

DESCRIPTION OF INSTITUTION

Bank of Frio Canyon is a small, independent community bank located in Real County, Texas. The bank operates out of one office in Leakey, approximately 95 miles northwest of San Antonio.

Bank of Frio Canyon offers a full line of deposit and loan products as well as night depository and drive-up motor banking services. The bank’s lobby is open for business weekdays between 9:00 a.m. and 3:00 p.m., with extended hours on Friday until 4:30 p.m. Drive-in teller lanes are open weekdays between 9:00 a.m. and 4:30 p.m.

Tables 1 and 2 below display the bank's asset composition and loan mix as of March 31, 2003. Bank of Frio Canyon reported total assets of \$29,709,000, an increase of 20 percent since the last evaluation. Net loans and leases increased substantially since the last evaluation, increasing 98 percent. Residential real estate lending has experienced the largest increase, but significant increases are noted in commercial and consumer loan product lines as well. Bank of Frio Canyon has not changed its lending focus or overall strategic plan since the last evaluation. The increase in residential real estate lending is attributed to the purchase and construction of second homes and the movement of families from urban cities to the more rural area.

No legal, regulatory, or other impediments preventing the bank from meeting credit needs were noted during the evaluation. The bank's product offerings and financial condition enable the bank to serve the credit needs of the community.

Table 1 – Asset Composition as of March 31, 2003		
Asset Type	Dollar Amount \$(000)	Percent of Total (%)
Cash and Balance Due From Banks	2,347	8
Securities	6,474	22
Federal Funds Sold	4,850	16
Loans and Leases, Net of Unearned Income and Allowance	15,619	53
Premises and Fixed Assets	150	0
Other Assets	269	1
Total	29,709	100

Source: Report of Condition and Income

Table 2 – Loan Distribution as of March 31, 2003		
Loan Type	Dollar Amount \$(000)	Percent of Total (%)
Construction and Land Development	2,984	19
Secured by Farmland	240	2
1-4 Family Residential	3,365	21
Commercial	4,562	29
<i>Total Real Estate Loans</i>	<i>11,151</i>	<i>71</i>
Agricultural	829	5
Commercial and Industrial	1,143	7
Consumer	2,648	17
Other	2	0
Less: Unearned Income	0	0
Total Loans	15,773	100

Source: Report of Condition and Income

DESCRIPTION OF ASSESSMENT AREA

Bank of Frio Canyon has defined its assessment area as all of Real County and one adjoining tract each in Uvalde and Edwards Counties. The assessment area encompasses a non-metropolitan statistical area (Non-MSA).

Of the three census tracts, one is designated as moderate-income and two are designated as middle-income. The moderate-income tract is located in the northern section of Edwards County and includes the City of Rocksprings. As indicated previously, the bank's office is located in Leakey, Texas in Real County. The entire county of Real is designated as a middle-income tract.

The assessment area is rural and sparsely populated. Real County covers 700 square miles with a population density factor of four residents per square mile. According to the 2000 U.S. Census, the population of Real County was 3,047, an increase of 26 percent over the 1990 U.S. Census. The county seat of Real is Leakey. In addition to Leakey, the county is also home to the City of Camp Wood. Camp Wood has a population of 822 and Leakey a population of 387. The assessment area also includes the City of Rocksprings in Edwards County and Utopia in Uvalde County. Utopia has a population of 241 and Rocksprings a population of 1,285.

The economy of the area is heavily supported by tourism and ranching. Leakey is located in an area known as Texas Hill Country, a large recreational area with numerous river camps, lodges, cabins, and parks. Activities include fishing, hunting, bird watching, camping, cycling, horseback riding, swimming and floating on the river. The area is surrounded by clear spring waters and scenic mountain roads. The area is also home to a large ranching community, with emphasis on goats and cattle.

The latest economic data indicates that the industry with the largest number of employees in Real County was educational, health and social services (22.7 percent); followed by agriculture, forestry, fishing and hunting, and mining (14.4 percent); and construction (13.6 percent). Of businesses surveyed by Dun & Bradstreet in 2002, 93 percent of all businesses in the assessment area employ nine or fewer persons and 98 percent have revenues less than \$1,000,000.

According to the Bureau of Labor Statistics, the unemployment rate in Real County was 4.9 percent for the second quarter of 2003. In comparison, state and national employment rates during this same period were 6.7 and 6.0 percent, respectively. The largest employers in Real County include Leakey Independent School District, Nueces Chamber of Commerce, Real People Homes Inc., Frio Canyon Feed & Supply, Old Timers, Texarome Inc, Texas Department of Transportation of Leakey, Bank of Frio Canyon, and Mount Laurell Inn. Local ranches also employ several workers as do the tourism and hunting industries. Several other large and small businesses provide additional employment opportunities in the area as well.

The assessment area is home to a number of families living below the poverty level and a large population of retired persons. The percentage of families below the poverty level in the assessment area is 18 percent, this is higher than Texas statewide average of 14 percent. In Real County, 21 percent of the population is age 65 and over, double that of the statewide average of

10 percent for Texas. According to the Department of Housing and Urban Development (HUD), median family income for the non-MSA area is estimated at \$41,200.

According to the 2000 U.S. Census, there are 4,223 housing units in the assessment area with a median housing value of \$45,917. Of these, 54 percent are owner-occupied, 14 percent are occupied rental units, and 32 percent are vacant units. According to bank management, the vacant units are predominantly second homes or vacation homes for out-of-town residents. Mobile homes account for 23 percent of total housing units in the assessment area and the median age of housing stock is 28 years.

A community contact was interviewed in Real County to ascertain local credit needs. The contact was of the opinion that residential real estate and commercial loans were the primary credit needs in the community. The contact indicated that there is a need for public housing and low-income housing. As far as commercial credit needs, the contact is of the opinion that Real County does have business opportunities related to the tourism and hunting industries.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

SAMPLING INFORMATION

Table 3 provides an analysis of the bank's year-to-date loan originations as of August 22, 2003.

Table 3 – 2003 Loan Originations as of August 22, 2003				
Loan Type	Dollar Amount (\$)	Percent of Dollar (%)	Number of Loans	Percent of Number (%)
Commercial	2,429,494	25	81	18
Residential Real Estate	3,951,107	41	53	12
Consumer	1,995,678	21	293	66
Agricultural	1,192,779	13	17	4
Total	9,569,058	100	444	100

Source: 2003 Loan Trial Balance as of August 22, 2003 (does not include paid-off loans)

Commercial and residential real estate loans were selected to review in analyzing the institution's lending performance as they capture the highest dollar volume of loans, 25 percent for commercial loans and 41 percent for residential real estate loans. According to management, the bank's primary focus is on residential real estate lending with a secondary emphasis on commercial lending. Although consumer loans capture a large portion of the bank's number of loans, they do not represent the bank's primary lending focus.

A sample of commercial (small business) and residential real estate loans originated in 2003 were chosen from Bank of Frio Canyon's trial balance for this analysis. Examiners selected 35 commercial loans totaling \$716,053 and 37 residential real estate loans totaling \$2,926,012 based on a 90 percent confidence interval and 15 percent precision level.

LOAN-TO-DEPOSIT RATIO

The bank's level of lending demonstrates an acceptable level of performance under this factor. As an indicator of lending activity, the bank's loan-to-deposit ratio was calculated for the nineteen quarters from September 30, 1998, through, March 31, 2003, using balances reported on the Consolidated Reports of Condition and Income. Table 4 shows the subject bank and other comparable area financial institutions of \$25 million to \$73 million in assets, with their average loan-to-deposit ratios for the same period. The institutions are listed alphabetically, with no inference of ranking.

Table 4 – Loan-to-Deposit Ratio Comparison				
Institution	Total Assets \$(000)	Total Deposits \$(000)	Net Loans \$(000)	Average LTD Ratio (%)
Bandera Bank Bandera, Texas	25,077	22,100	13,638	59
<i>Bank of Frio Canyon Leakey, Texas</i>	29,709	26,377	15,619	50
D'Hanis State Bank D'Hanis, Texas	28,684	25,699	16,414	60
National American Bank Uvalde, Texas	73,815	48,087	32,263	47
Peoples State Bank Rocksprings, Texas	40,034	35,262	10,352	22

Source: Reports of Condition and Income

Each of the banks listed in Table 4 are comparable either by asset size and/or loan mix to Bank of Frio Canyon. Table 4 highlights Bank of Frio Canyon's ratio and compares it to the listed banks. The bank's ratio has shown a steady increase since the last evaluation increasing from 38 percent at the last evaluation to 50 percent at this evaluation. Overall, the bank's performance under this factor indicates an acceptable level of lending activity.

LENDING IN THE ASSESSMENT AREA

Analysis of the small business and residential real estate loan samples reflects an excellent record of lending within the bank's assessment area. The analysis of lending in the assessment area takes into consideration the size of the assessment area, the size of the bank, the location of the bank's offices, and the type of loan products reviewed.

Small Business Loans

The small business loan analysis revealed that a substantial majority of the bank's loan originations are within the assessment area. Of the 35 loans sampled, 31 loans with a total dollar volume of \$637,053 were located within the assessment area. This represents 89 percent of the number of loans and 89 percent of loans by dollar volume.

Residential Real Estate Loans

The residential real estate loan analysis also revealed that a substantial majority of the bank's loans are extended within its assessment area. Of the 37 loans sampled, 36 loans with a total dollar volume of \$2,904,963 were located within the assessment area. This encompasses 99 percent of the number and 97 percent of the dollar volume of residential real estate loans.

Relative to lending in the assessment area, the bank has demonstrated an excellent level of performance under this factor.

LENDING TO BORROWERS OF DIFFERENT INCOMES AND BUSINESSES OF DIFFERENT SIZES.

The bank’s record of dispersing loans to borrowers of different incomes and businesses of different sizes is satisfactory. The bank has an acceptable record of lending to small businesses and a reasonable distribution of residential real estate loans to low- and moderate-income borrowers.

Small Business Loans

Tables 5 and 6 display the bank's distribution of the 31 small business loans inside the assessment area by both the dollar amount of the loan and the revenue size of the business.

Table 5 - Distribution of Small Business Loans by Loan Size				
Loan Size	Bank Number of Loans	Bank Number of Loans (%)	Bank Dollar Volume (\$)	Bank Dollar Volume (%)
≤ \$100,000	29	94	392,084	62
>\$100,000 but ≤ \$250,000	2	6	244,969	38
>\$250,000 but ≤ \$1,000,000	0	0	0	0
>\$1,000,000	0	0	0	0
Total	31	100	637,053	100

Source: Bank records

Table 5 shows that 100 percent of the bank's small business loans are in amounts of \$250,000 or less, with a significant percentage of small loans of \$100,000 or less (94 percent). These high percentages are expected as the bank’s legal lending limit is only \$300,000. By dollar, the stratification is less for loans of \$100,000 or less, but this is reasonable as a few high dollar loans can easily outweigh a larger number of smaller loans.

Table 6 – Distribution of Small Business Loans by Gross Annual Revenues of Business					
Gross Annual Revenues	Bank Number of Loans	Bank Number of Loans (%)	Number of Businesses *	Bank Dollar Volume (\$)	Bank Dollar Volume (%)
≤ \$1,000,000	13	42	98	225,061	35
> \$1,000,000	18	58	2	411,992	65
Total	31	100	100	637,053	100

Source: Bank records, *- Dun & Bradstreet

Table 6 indicates that 42 percent of the number and 35 percent of the dollar volume of small business loans were extended to businesses with gross annual revenues less than or equal to \$1 million. By comparison, figures noted for businesses surveyed by Dun & Bradstreet reported that 98 percent of all businesses in the assessment area reflect revenues of less than \$1 million. Although the bank's distribution is significantly less than the revenue numbers compiled by Dun and Bradstreet, the distribution is skewed as the bank makes a large number of small loans to two businesses in the area. Both of these businesses have gross annual revenues greater than \$1 million.

Consideration must be given to the fact that 16 of the 31 loans sampled are to the two local businesses. Thirteen loans were to a one of the largest employers in Real County. The other three loans were to a local contractor who has large government contracts with the state of Texas.

Outside of these two businesses, 87 percent of the remaining industries have gross annual revenues less than \$1 million. After taking into account the large number of repeat borrowers in the loan sample, the bank's performance reflects an adequate distribution.

The data presented, by loan and revenue size, illustrates that the bank is meeting the needs of small businesses in the assessment area. Lending under this factor to small business borrowers reflects a reasonable distribution.

Residential Real Estate Loans

For residential real estate loans, the bank has demonstrated an adequate level of performance in lending to borrowers of different income levels. Residential real estate lending is analyzed using borrower incomes and comparing them to the percentage of families, by income level, in the assessment area. Borrower income levels calculated in Table 7 were based on 2003 HUD estimated statewide area median family income for the Non-MSA area.

Table 7 – HUD Median Family Income for Non-MSA Area	
Income Level	2003 Median Family Income of \$41,200
Low (less than 50%)	Less than \$20,600
Moderate (50% to less than 80%)	At least \$20,600 but less than \$32,960
Middle (80% to less than 120%)	At least \$32,960 but less than \$49,440
Upper (120% and over)	\$49,440 or greater

Detailed in Table 8 is an analysis of the 36 loans inside the assessment area. The income levels listed for total families were based on 2000 U.S. Census data.

Table 8 – Distribution of Residential Real Estate Loans by Borrower Income					
Borrower Income Level	% of Total Families	Bank Number of Loans	Percent of Number (%)	Bank Dollar Volume (\$)	Percent of Dollar (%)
Low	28	2	5	60,025	2
Moderate	20	1	3	12,000	1
Middle	24	9	25	503,758	17
Upper	28	24	67	2,329,180	80
Total	100	36	100	2,904,963	100

The majority of the bank's residential real estate loans are home purchase loans, the bulk of these are second homes or vacation homes. The bank has few requests for home improvement loans, they do not offer home equity loans, and they originate very few mobile home loans. Due to competitive mobile home financing available from lender such as Greentree Financial and the high depreciation factor involved with this type of collateral, the bank does not typically originate mobile home loans.

As indicated in Table 8, a large percentage of loans sampled, by number and dollar volume, fell into the upper-income category. The majority of these loans are for second homes or vacation homes; these borrowers typically have higher incomes. Also, land values in the Texas Hill Country have risen since the last evaluation. Management indicated that the only new properties being developed in the area are river lots or 3 to 5 acre tracts of land, both of which are very expensive. According to a local realtor, the real estate market in the assessment area has priced lower-income families out of qualifying for home purchase loans. The realtor was of the opinion that homes near the river typically are priced from \$150,000 to \$400,000. Other homes are

priced from \$60,000 to \$80,000, with few permanent homes available at the lower prices. According to the realtor, the lower-priced homes are typically manufactured or mobile homes.

Table 8 also indicates that a large percentage of total families are of low- and moderate-incomes. According to management, the majority of lower income families in the assessment area are composed of young adults, with lower educational levels and minimum wage jobs. Also, Table 8 shows that the number and dollar volume of loans extended to low- and moderate-income borrowers is less than the percentage of families in the assessment area. The bank's lower percentages are acceptable as the percentages reflected for total families do not take into account the ability of low- and moderate-income borrowers to qualify for these higher dollar loans.

Also, consideration must be given to assessment area demographics, the fact that the assessment area has a number of families living below the poverty level, a high percentage of retired persons, and a large number of residents living in mobile homes. As indicated previously, 18 percent of families in the assessment area live below the poverty level. Additionally, 21 percent of the population is age 65 and over, many of them living on fixed lower incomes. It would be more difficult for both of these categories of families to qualify for home purchase loans. Also, as indicated previously, mobile homes account for 23 percent of total housing units. Mobile home borrowers typically fall into lower-income ranges and, as indicated above, the bank originates few such loans.

As discussed above, the bank's stratification of loans to low- and moderate-income borrowers is adequate after taking into account the assessment area demographics and the difficulty of lower-income borrowers to qualify for these higher dollar loans.

Overall, the analysis of small business and residential real estate lending reflects an adequate distribution of loans to borrowers of different incomes and businesses of different sizes.

GEOGRAPHIC DISTRIBUTION OF LENDING

The geographic distribution of small business and residential real estate loans reflects a reasonable dispersion among various geographies within the bank's assessment area. To evaluate the bank's performance under this factor, the geographic distribution of small business and residential real estate loans is compared to the percentage of census tracts within each income level.

Small Business Loans

For small business loans, the bank has demonstrated a reasonable record of lending to various geographies within its assessment area. Table 9 displays the bank's geographic distribution of the 31 small business loans sampled and the percentage of census tracts in each income level.

Table 9 – Distribution of Small Business Loans by Census Tract					
Income Level of Census Tract	Percent of Tracts (%)	Bank Number of Loans	Percent of Number (%)	Bank Dollar Volume (\$)	Percent of Dollar (%)
Low	0	0	0	0	0
Moderate	33	0	0	0	0
Middle	67	31	100	637,053	100
Upper	0	0	0	0	0
Total	100	31	100	637,053	100

The bank’s assessment area has no low-income tracts, one moderate-income tract, and two middle-income tracts. Although the bank has made no loans in the moderate-income tract in Rocksprings, this is expected as the city is 53 miles from the bank and other banking options are available in Rocksprings. Of the bank’s 31 small business loans, 77 percent of the borrowers reside in Leakey, near the bank’s office.

Given the local competition and the location of the bank’s office, the bank’s performance in the moderate-income geography is considered reasonable.

Residential Real Estate Loans

The bank’s record of lending to residential borrowers in various geographies within its assessment area is also considered reasonable. Table 10 shows the geographic distribution of the bank’s 36 residential real estate loans and the percentage of census tracts in each income level.

Table 10 – Distribution of Residential Real Estate Loans by Census Tract					
Income Level of Census Tract	Percent of Tracts (%)	Bank Number of Loans	Percent of Number (%)	Bank Dollar Volume (\$)	Percent of Dollar (%)
Low	0	0	0	0	0
Moderate	33	2	6	257,500	9
Middle	67	34	94	2,647,463	91
Upper	0	0	0	0	0
Total	100	36	100	2,904,963	100

As indicated previously, the bank has no low-income tracts and one moderate-income tract in Rocksprings. Although the bank has made only six percent of residential real estate loans in the moderate-income area, this is expected due to the distance of the bank from this geography and the other banking options available in the City of Rocksprings. Consequently, the data presented above reflects adequate performance in lending in the moderate-income geography.

Overall, the dispersion of small business and residential real estate loans among the various geographies in the bank's assessment area reflects reasonable performance.

RESPONSE TO CRA COMPLAINTS

No complaints relating to the bank's performance under the Community Reinvestment Act were received since the previous evaluation on July 28, 1998. As a result, this factor does not impact the bank's performance evaluation.

FAIR LENDING

No violations of the substantive provisions of anti-discrimination laws and regulations were identified.

INVESTMENTS AND SERVICES

Bank management did not request a review of the bank's investments and services in consideration of an outstanding rating.

APPENDIX A - GENERAL DEFINITIONS

GEOGRAPHY TERMS

Assessment Area: A geographic area delineated by the bank in accordance with the requirements of the Community Reinvestment Act.

Census Tract: A small, relatively permanent statistical subdivision of a county or statistically equivalent entity. Census tracts are designed to be homogeneous units with respect to population characteristics, economic status, and living conditions at the time they are established. Census tracts generally contain between 1,000 and 8,000 people, with an optimum size of 4,000.

Metropolitan Statistical Area (MSA): Consists of one or more counties or core areas with a large population nucleus, together with adjacent communities that have a high degree of economic and social integration with that core.

INCOME TERMS

Median Family Income: Family income derived from the 2000 U.S. Census data and adjusted by the Department of Housing and Urban Development (HUD) annually for metropolitan and non-metropolitan areas. HUD starts with the most recent U.S. Census data and factors in information from other sources to arrive at an annual estimate that more closely reflects current economic conditions. Half of the family incomes are estimated below and half are estimated above this figure.

Low-Income: Individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent in the case of a geography.

Moderate-Income: Individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 and less than 80 percent in the case of a geography.

Middle-Income: Individual income that is at least 80 percent and less than 120 percent of the area median income, or a median family income that is at least 80 percent and less than 120 percent in the case of a geography.

Upper-Income: Individual income that is more than 120 percent of the area median income, or a median family income that is more than 120 percent in the case of a geography.

OTHER TERMS

Dun & Bradstreet: The Dun & Bradstreet Corporation is a provider of business and financial information drawn from a global database of more than 50 million businesses.

Family: A family includes a householder and one or more other people living in the same household who are related to the householder by birth, marriage, or adoption. A household can only contain one family for purposes of census tabulations. Not all households contain families since a household may be comprised of a group of unrelated people or of one person living alone.

Household: A household includes all the people who occupy a housing unit. A housing unit is a house, an apartment, a mobile home, a group of rooms, or a single room occupied as separate living quarters (or if vacant, intended for occupancy). The occupants may be a single family, one person living alone, two or more families living together, or any other group of related or unrelated people who share living quarters.