MSDS 6372 Project 1:

Building Regression Models to Predict House Prices

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June 16, 2018

# Introduction

# When buying a house, we look at a lot of features, its square feet area, number of bedrooms, bathrooms, frontyards & backyards, location, the look of the kitchen, location, etc. As it happens, the price itself is dependent on many factors. This project tries to understand the underlying factors that go into determined the sale price of houses. The goal of this project is to build a predictive model that can identify and capture the variance in the data as accurately as possible in order to use this data to predict future house prices.

# We are using a dataset of houses in Ames, Iowa. This dataset provides many features of a house that would give a better idea of what and how much do each of these features affect the final sale price. The dataset there are 80 explanatory variables describing every aspect of residential homes in Ames, Iowa such as Street, Neighborhood, LotShape, LandSlope, YearBuilt, FullBath, GarageCars, Fireplaces and Pool Quality, etc. for 2,930 homes.

# We are trying to answer 2 questions:

1. What are the important features and factors that impact house prices, and can we build a model that can accurately predict the price of a house? To answer this, we built many multiple variable regression models, compared their relative performance, and chose the model that did a better job at prediction. We also interpret this model and perform hypothesis testing on it.

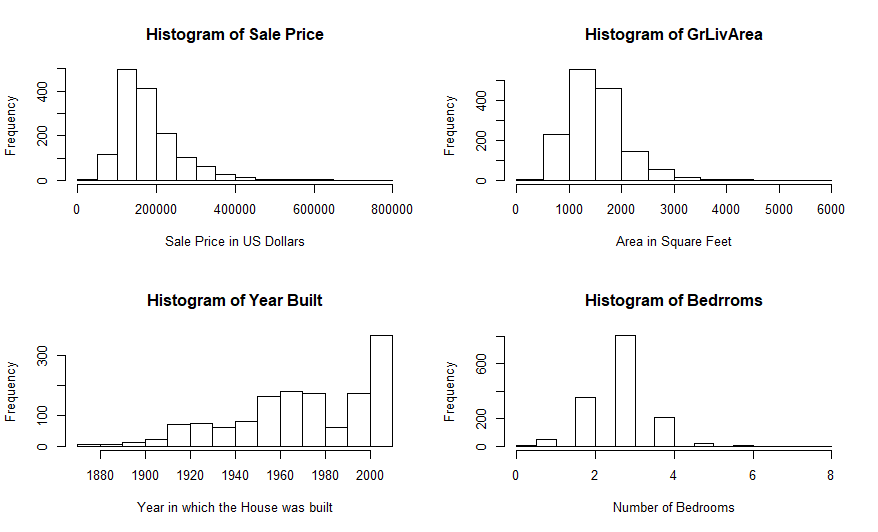
2. If we were to use only two important categorical variables to estimate and predict the price of a house, how can we assess such a model and estimate the influence of each of the two variables in house prices? To answer this, we chose the “Kitchen Quality” and “Neighborhood” variables, and perform two-way ANOVA analysis.

# Data Description

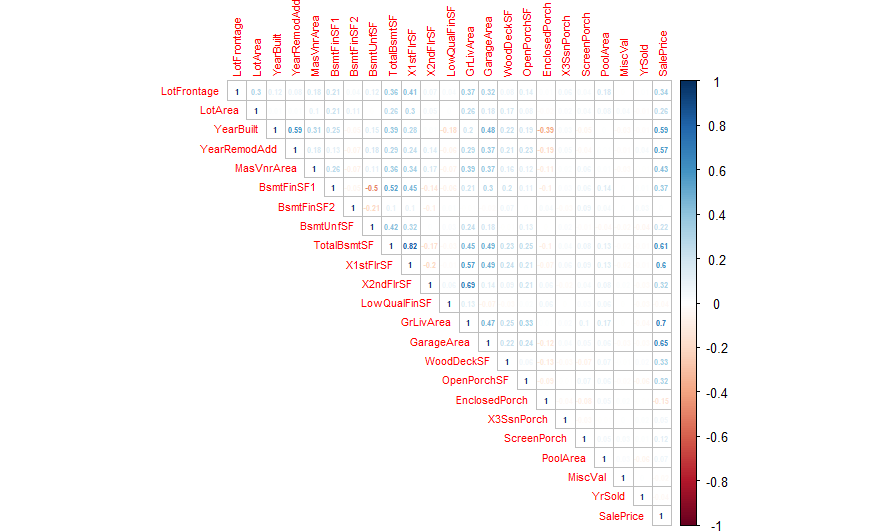
The data set (available at http://www.amstat.org/publications/jse/v19n3/decock/AmesHousing.txt) contains information from the Ames Assessor’s Office used in computing assessed values for individual residential properties sold in Ames, IA from 2006 to 2010. The dataset has 1460 observations of 80 variables related to the house, its features, and surroundings: 23 nominal, 23 ordinal, 14 discrete, and 20 continuous. A summary table of the variables can be found in the Appendix.

# Exploratory Analysis

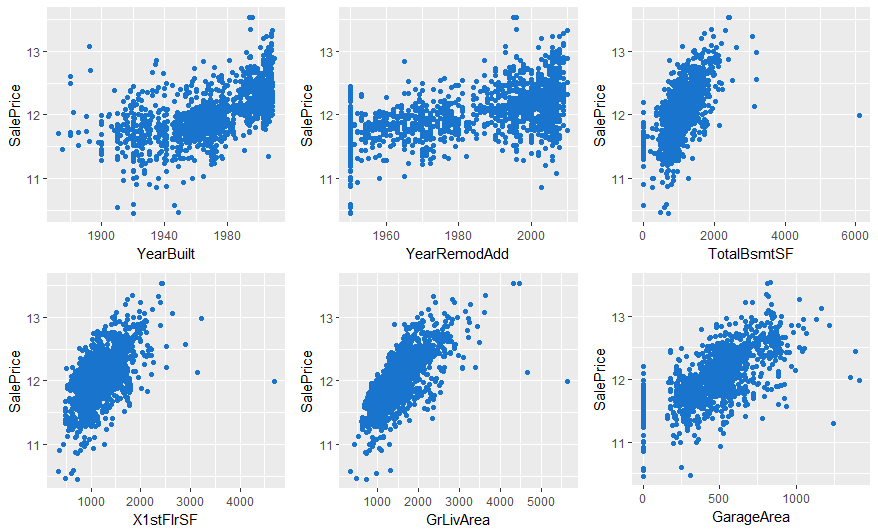
First, we’ll try to understand general features of the houses been sold. Doing some summary statistics and charts, we can draw the following conclusions: the median sale price is $163,000, most of the houses sold have an above the ground area between 1,000 and 2,000 sq ft, a large proportion of houses are fairly recent (built after the year 2000) and 3-bedroom houses are the most popular.



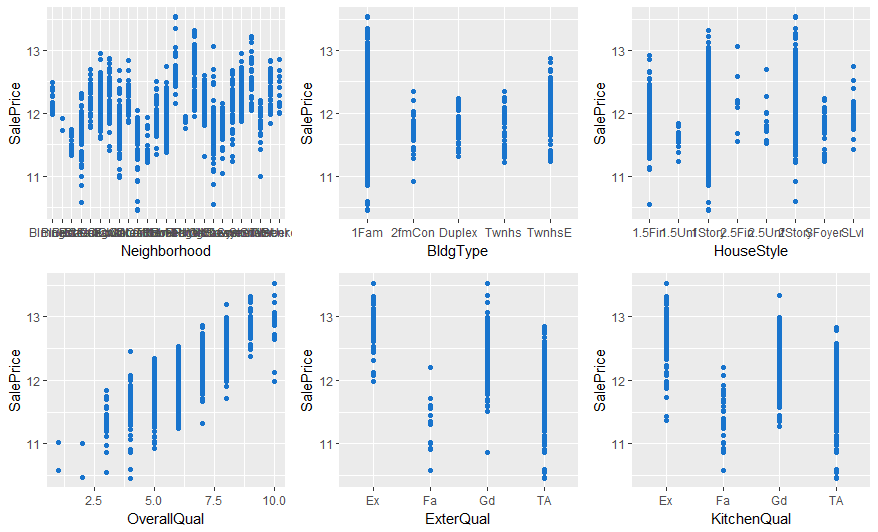
# We also want to understand which numeric variables are strongly correlated with the sale price, and whether multicollinearity may exist. For this, we create a correlation matrix as the one shown below:



# As expected, we find that variables related to the size of the home (TotalBSmtSF, X1stFlrSF, GrLivArea, Garage Area) are strongly, positively correlated with price, and at the same time these variables show moderate to strong correlations with each other. Another important correlation is related to the year that the home was build and remodeled (we also found that 42% of the houses were not remodeled, and that the average number of years before building and adding/remodeling is 13.6)



# We also want to understand which categorical variables can influence Sale Price. We present selected scatterplots below:



# Addressing Objective 1:

## Restatement of Problem

We want to create a model that accurately predicts the sale price of a house in Ames, Iowa, and identify which features of a home are more influential in determining its Sale Price.

The overall strategy will be:

1. Create a model with all features included, and perform residual, leverage and Cook’s D analysis on this model, assessing which observations with high leverage need to be removed

2. Create different models using widely adopted regression techniques (including interaction terms, forward, backwards and stepwise selection, and LASSO)

3. Check the model’s assumptions and perform influential point analysis

4. Assess and compare the models, selecting the one with the highest adjusted R-squared. criteria.

## Model Selection

We created 6 models:

1. An initial model that includes all variables in the dataset

2. A model including the following interaction terms: KitchenQual \* Neighborhood, SaleCondition \* Neighborhood, OverallCond \* OverallQual, GarageYrBlt \* GarageCars \* GarageArea.

2. A LASSO Model

3. Three models using automated variable selection techniques (forward, backwards and stepwise), using the p-value as criteria for including and removing variables.

## Comparing Competing Models

|  |  |
| --- | --- |
| **Predictive Models** | **Adjusted R2** |
| All features included | 0.9698447 |
| Model without interactions | 0.9698447 |
| Model with interactions | 0.9718073 |
| LASSO | 0.8768 |
| Forward | 0.9641 |
| Backward | 0.9648 |
| Stepwise | 0.9648 |

We select the model with the highest Adjusted R-Squared, the backwards selection model.

## Checking Assumptions

|  |  |
| --- | --- |
| Residuals Plot | QQ Plot |
| The residuals plot shows a pattern similar to a random cloud of plots. This provides evidence in favor of the assumption of normality. | The qq-plot confirms the assumption of normality of the residuals, because we don’t see large deviations from the theoretical quantiles of a normal distribution. |
| Studentized Residuals | Leverage and Cook’s D |
| The studentized residuals do not show high values that would create worries about outliers. This reinforces the conclusion that the assumptions of linear regression are met. | A common rule of thumb is that an observation with a value of Cook's D over 1.0 has too much influence. The chart shows that we do not have observations with high leverage (we removed them on a previous step). |

## Parameter Interpretation

The complete results of the selected linear regression model are shown in the appendix. We present below an example of coefficient interpretation:

| **Parameter** | **Estimate** | **95% Confidence Limits** | | **Interpretation** |
| --- | --- | --- | --- | --- |
| **GrLivArea** | 0.000219444 | 0.000197 | 0.000242 | An increase of 1 square feet in the Above Ground Living area increases the price by 0.0219%, or equivalently, increasing the area by 100 feet would increase the price of the house by 2.19%. A 95% confidence level of this estimate is between 0.0197% and 0.0242%. |

## Conclusion

After performing the data processing, removing influential observations, creating 6 models, comparing them and checking the assumptions; based on the adjusted R-squared we selected the backwards selection model as the best predictors of house prices.

## Appendix

Dataset description

|  |  |  |  |
| --- | --- | --- | --- |
| **Discrete Variables** | **Nominal Variables** | **Ordinal** | **Continuous** |
| Order: Observation number | MS SubClass: Identifies the type of dwelling involved in the sale. | Lot Shape: General shape of property | Lot Frontage: Linear feet of street connected to property |
| Year Built : Original construction date | PID: Parcel identification number - can be used with city web site for parcel review. | Utilities: Type of utilities available | Lot Area: Lot size in square feet |
| Year Remod/Add : Remodel date (same as construction date if no remodeling or additions) | Street: Type of road access to property | Land Slope: Slope of property | Mas Vnr Area: Masonry veneer area in square feet |
| Bsmt Full Bath : Basement full bathrooms | Alley: Type of alley access to property | Overall Qual: Rates the overall material and finish of the house | BsmtFin SF 1: Type 1 finished square feet |
| Bsmt Half Bath : Basement half bathrooms | Land Contour: Flatness of the property | Overall Cond: Rates the overall condition of the house | BsmtFin SF 2: Type 2 finished square feet |
| Full Bath : Full bathrooms above grade | Lot Config: Lot configuration | Exter Qual: Evaluates the quality of the material on the exterior | Bsmt Unf SF: Unfinished square feet of basement area |
| Half Bath : Half baths above grade | Neighborhood: Physical locations within Ames city limits (map available) | Exter Cond: Evaluates the present condition of the material on the exterior | Total Bsmt SF: Total square feet of basement area |
| Bedroom : Bedrooms above grade (does NOT include asement bedrooms) | MS Zoning: Identifies the general zoning classification of the sale. | Bsmt Qual: Evaluates the height of the basement | 1st Flr SF: First Floor square feet |
| Kitchen : Kitchens above grade | Condition 1: Proximity to various conditions | Bsmt Cond: Evaluates the general condition of the basement | 2nd Flr SF : Second floor square feet |
| TotRmsAbvGrd: Total rooms above grade (does not include bathrooms) | Condition 2: Proximity to various conditions (if more than one is present) | Bsmt Exposure : Refers to walkout or garden level walls | Low Qual Fin SF: Low quality finished square feet (all floors) |
| Fireplaces : Number of fireplaces | Bldg Type: Type of dwelling | BsmtFin Type 1 : Rating of basement finished area | Gr Liv Area: Above grade (ground) living area square feet |
| Garage Yr Blt : Year garage was built | House Style: Style of dwelling | BsmtFinType 2 : Rating of basement finished area (if multiple types) | Garage Area: Size of garage in square feet |
| Garage Cars : Size of garage in car capacity | Roof Style: Type of roof | HeatingQC: Heating quality and condition | Wood Deck SF: Wood deck area in square feet |
| Mo Sold : Month Sold (MM) | Roof Matl: Roof material | Electrical: Electrical system | Open Porch SF: Open porch area in square feet |
| Yr Sold : Year Sold (YYYY) | Exterior 1: Exterior covering on house | KitchenQual: Kitchen quality |  |
|  | Exterior 2: Exterior covering on house (if more than one material) | Functional: Home functionality (Assume typical unless deductions are warranted) | Enclosed Porch: Enclosed porch area in square feet |
|  | Mas Vnr Type: Masonry veneer type | FireplaceQu: Fireplace quality | 3-Ssn Porch: Three season porch area in square feet |
|  | Foundation: Type of foundation | Garage Finish : Interior finish of the garage | Screen Porch: Screen porch area in square feet |
|  | Heating : Type of heating | Garage Qual: Garage quality | Pool Area: Pool area in square feet |
|  | Central Air: Central air conditioning | Garage Cond: Garage condition | Misc Val: $Value of miscellaneous feature |
|  | Garage Type: Garage location | Paved Drive: Paved driveway | SalePrice: Sale price $$ |
|  | Misc Feature: Miscellaneous feature not covered in other categories | Pool QC: Pool quality |  |
|  | Sale Type: Type of sale | Fence: Fence quality |  |
|  | Sale Condition: Condition of sale |  |  |

Model coefficients and confidence intervals

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Estimate** | **tvalue** |  | **Pr(>|t|)** | **95% Confidence Interval** |  |
| (Intercept) | 5.011129102 | 9.251 | < | 2E-16 | 3.94942 | 6.072841471 |
| MSZoningFV | 0.403631756 | 7.715 |  | 2.36E-14 | 0.30109 | 0.506174298 |
| MSZoningRH | 0.359972682 | 5.948 |  | 3.4635E-09 | 0.24135 | 0.478590892 |
| MSZoningRL | 0.382505402 | 7.824 |  | 1.04E-14 | 0.28668 | 0.47832802 |
| MSZoningRM | 0.277273323 | 5.642 |  | 2.0498E-08 | 0.18095 | 0.373594876 |
| LotArea | 2.7266E-06 | 5.66 |  | 1.8543E-08 | 1.8E-06 | 3.67073E-06 |
| OverallQual | 0.082591441 | 17.41 | < | 2E-16 | 0.07329 | 0.091889034 |
| YearBuilt | 0.000518011 | 2.337 |  | 0.019582 | 8.4E-05 | 0.000952441 |
| YearRemodAdd | 0.002198544 | 9.194 | < | 2E-16 | 0.00173 | 0.002667255 |
| BsmtFinType1BLQ | -0.021113202 | -1.419 |  | 0.156141 | -0.0503 | 0.00805009 |
| BsmtFinType1GLQ | 0.010890701 | 0.847 |  | 0.397342 | -0.0143 | 0.036102721 |
| BsmtFinType1LwQ | -0.032329069 | -1.71 |  | 0.087537 | -0.0694 | 0.00473098 |
| BsmtFinType1None | -0.138579522 | -4.087 |  | 4.6223E-05 | -0.205 | -0.07212836 |
| BsmtFinType1Rec | -0.015689948 | -1.002 |  | 0.31632 | -0.0464 | 0.014987924 |
| BsmtFinType1Unf | -0.065413977 | -4.534 |  | 6.3144E-06 | -0.0937 | -0.03713488 |
| BsmtFinSF1 | -9.8721E-06 | -0.683 |  | 0.494877 | -4E-05 | 1.84679E-05 |
| TotalBsmtSF | 0.000033862 | 1.522 |  | 0.128255 | -1E-05 | 7.74698E-05 |
| CentralAirY | 0.096854817 | 5.499 |  | 4.574E-08 | 0.06233 | 0.131376614 |
| X1stFlrSF | 3.43894E-05 | 1.473 |  | 0.141028 | -1E-05 | 8.01532E-05 |
| GrLivArea | 0.000219444 | 19.15 | < | 2E-16 | 0.0002 | 0.000241903 |
| BsmtFullBath | 0.03550363 | 3.72 |  | 0.000207 | 0.0168 | 0.054208056 |
| FireplaceQuFa | -0.069661998 | -1.735 |  | 0.082941 | -0.1483 | 0.009025929 |
| FireplaceQuGd | -0.031833525 | -0.979 |  | 0.327828 | -0.0956 | 0.03190782 |
| FireplaceQuNone | -0.107902315 | -3.244 |  | 0.001209 | -0.1731 | -0.04270254 |
| FireplaceQuPo | -0.071685694 | -1.59 |  | 0.112051 | -0.16 | 0.016676284 |
| FireplaceQuTA | -0.072748968 | -2.207 |  | 0.027449 | -0.1373 | -0.00815644 |
| GarageTypeAttchd | 0.191318693 | 2.794 |  | 0.005279 | 0.05711 | 0.325524345 |
| GarageTypeBasment | 0.123820629 | 1.631 |  | 0.103153 | -0.025 | 0.272629086 |
| GarageTypeBuiltIn | 0.205515194 | 2.911 |  | 0.003661 | 0.06715 | 0.343881464 |
| GarageTypeCarPort | 0.07644253 | 0.94 |  | 0.347319 | -0.0829 | 0.235810416 |
| GarageTypeDetchd | 0.163567393 | 2.391 |  | 0.016955 | 0.02947 | 0.297667688 |
| GarageTypeNone | 0.134487297 | 1.841 |  | 0.065777 | -0.0087 | 0.277632371 |
| GarageCars | 0.062977127 | 5.388 |  | 8.4282E-08 | 0.04007 | 0.085887464 |
| GarageArea | 6.91836E-05 | 1.759 |  | 0.078739 | -8E-06 | 0.000146255 |