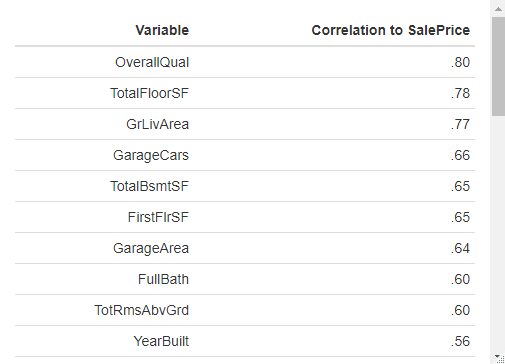
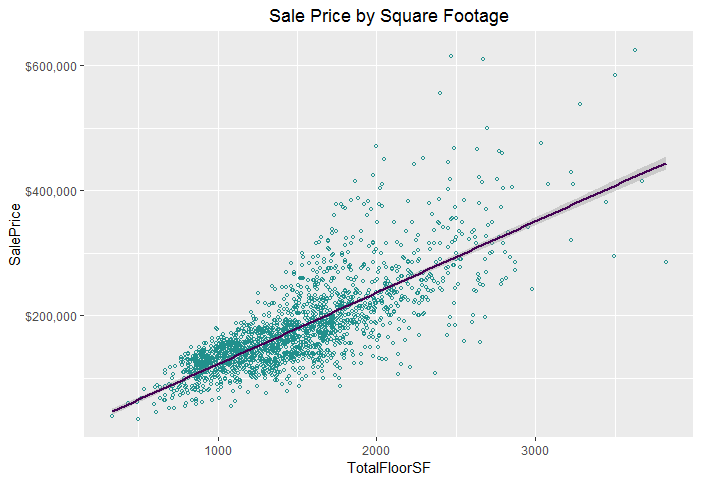


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| Modeling Assignment #2: Building Linear Regression Models  *MSDS 410* |

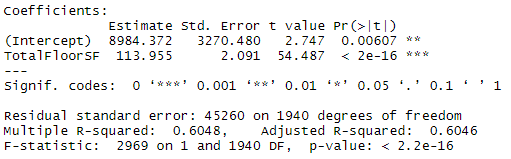
*PART A: Simple Linear Regression Models*

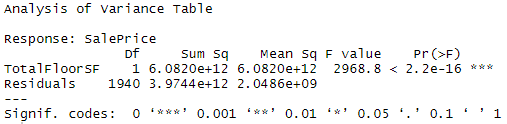
1. I have chosen TotalFloorSF as my explanatory variable to predict SalePrice. The following table shows the 10 non-factor variables with the highest Pearson correlation to SalePrice. TotalFloorSF has the highest correlation after OverallQual (which I have ignored due to it being used in section 2 below.)



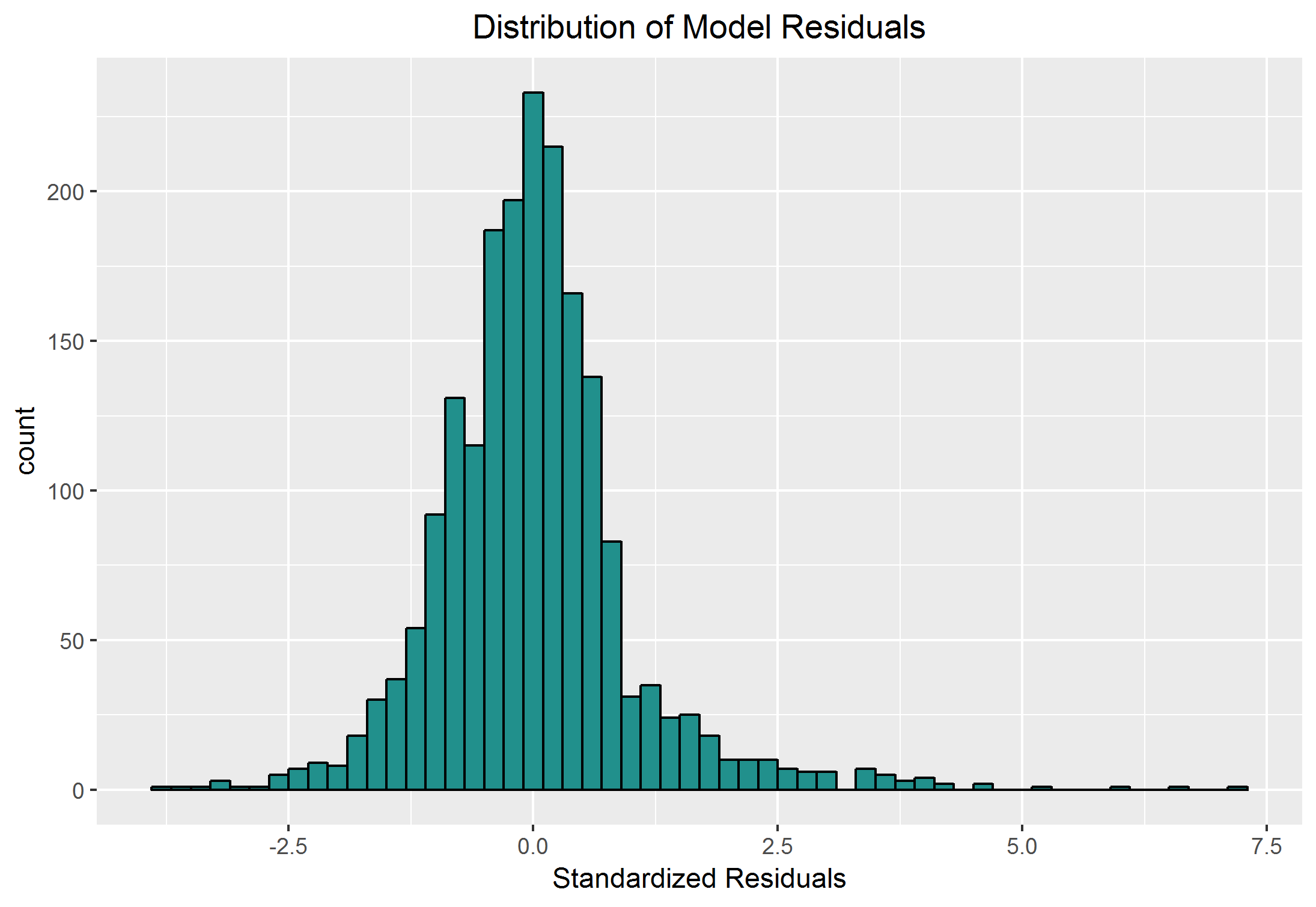


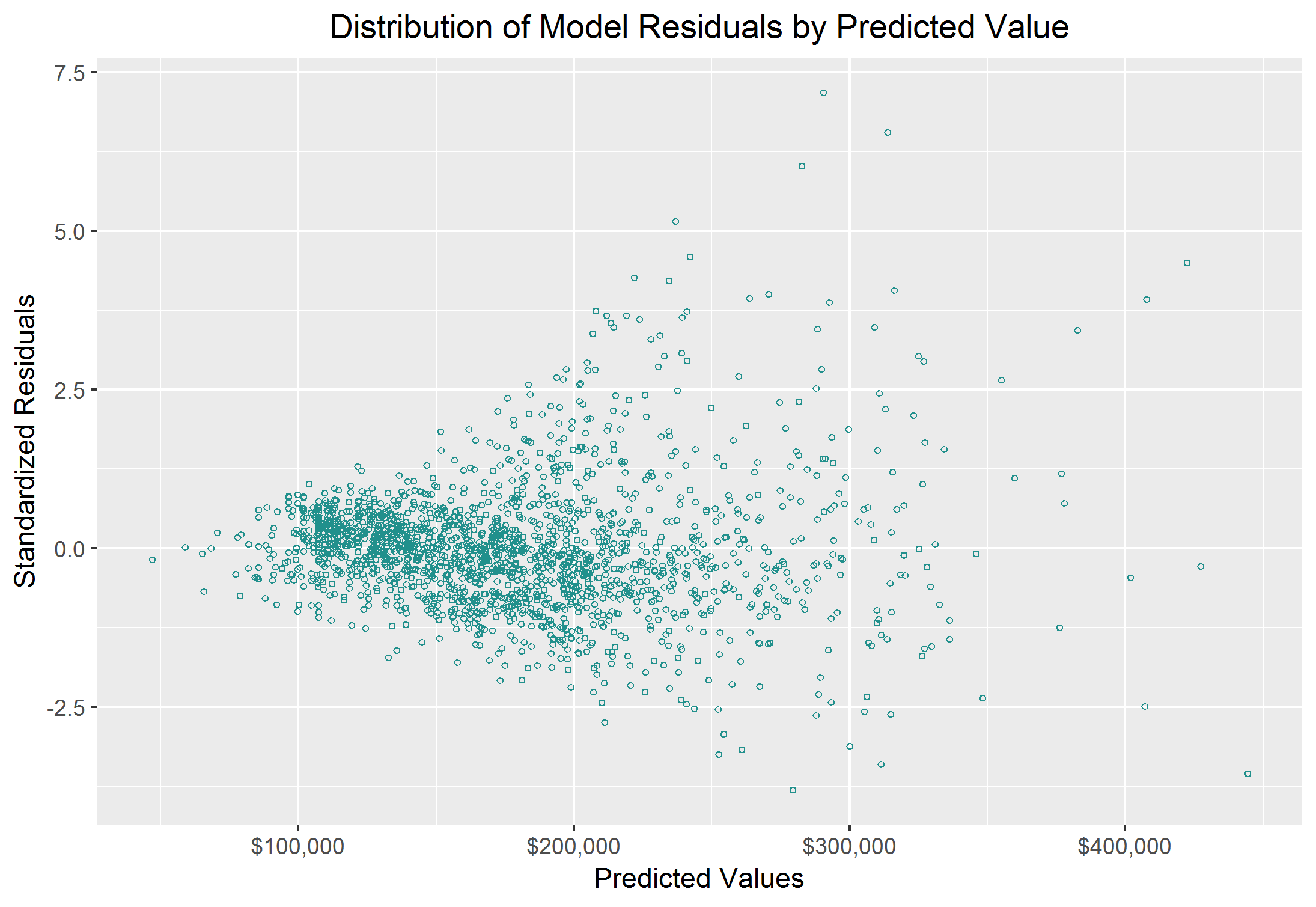
* 1. Y = 113.955\*TotalFloorSF + 8984.372
     + 8984.372: Our intercept is the value of a home that has 0 total square feet. This is outside of the realistic parameters of our model and could not be used to estimate an empty plot of land. It simply serves as the y-intercept of the line of best fit.
     + 113.955\*TotalFloorSF: For every square foot increase in size of the home, the predicted price increases by $113.96.
  2. R-Squared: 0.605
     + This model accounts for 60.5% of the variance in SalePrice.





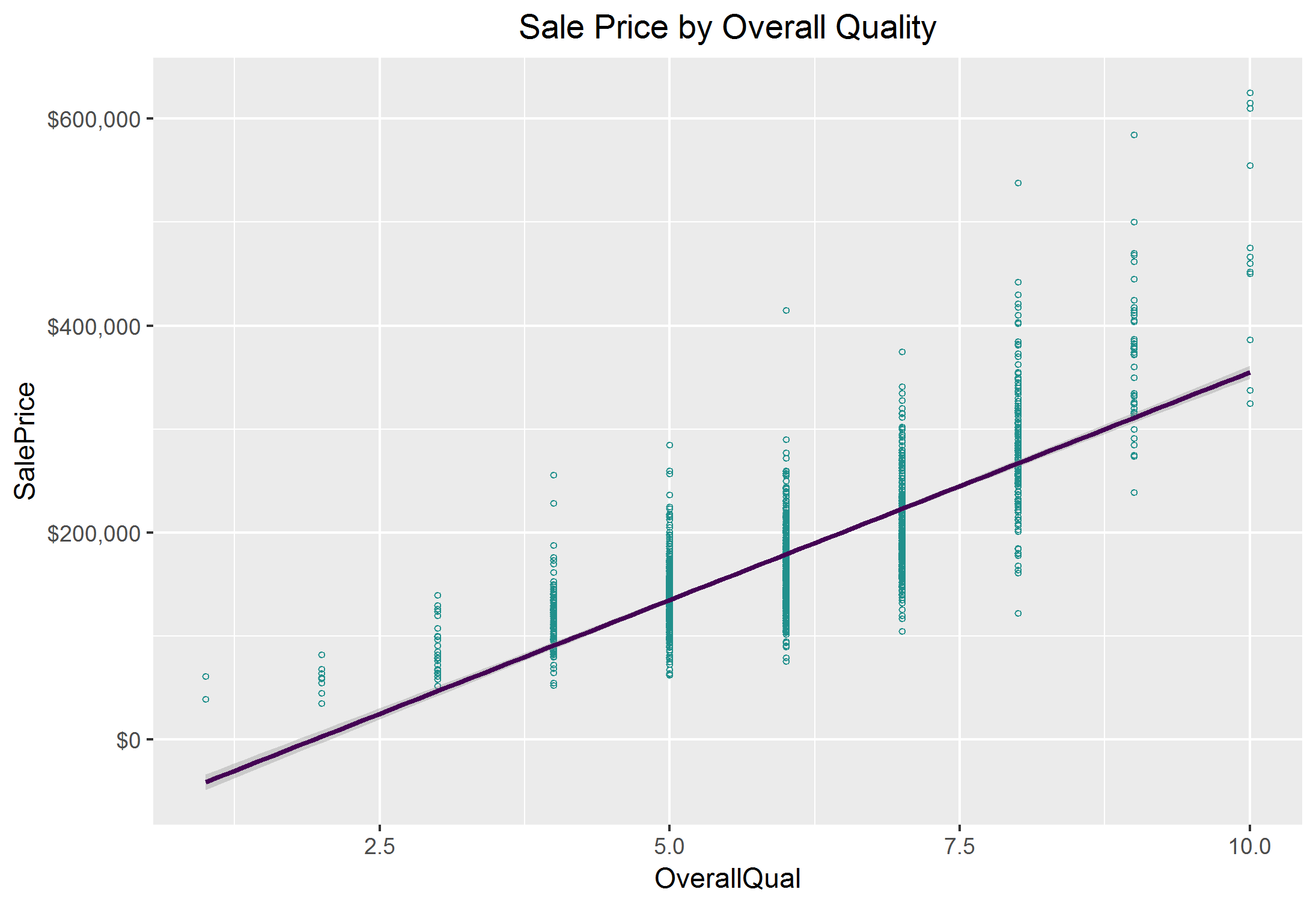
* Intercept Hypothesis Test:
  + H0: β0 = 0
  + HA: β0 does not equal 0
  + Reject the null hypothesis at the 0.001 level
* TotalFloorSF Hypothesis Test:
  + H0: β1 = 0
  + HA: β1 does not equal 0
  + Reject the null hypothesis at the 0 level
* Omnibus Hypothesis Test:
  + H0: All betas included in model (in our case only one) = 0
  + HA: At least one beta does not equal 0
  + We reject the null hypothesis and conclude that our model significantly explains the variance of SalePrice.
  1. The validity of the hypothesis tests are dependent on the underlying assumptions of Independence, Normality, and Homoscedasticity being well met. To assess this, use the model from part a) to calculate predicted values for each record. Then use the predicted values to compute residuals. Yes, many of the packages automatically give you the predicted and residuals, but you should know how to code and compute these values. Next standardize the residuals but subtracting off the mean and dividing by the standard deviation for each residual (i.e. you will have to obtain those summary statistics first). Check on the underlying assumptions by plotting:



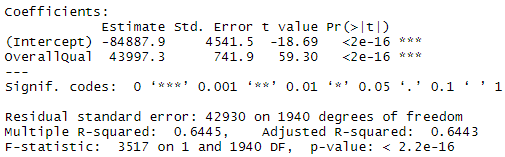


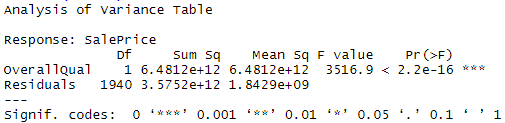
In the scatter plot graph, there is a clear fan shape formed by the residuals, which suggests a violation of the assumption of homoscedasticity. There appear to be some extreme outliers, which can be observed in the far right tail of the histogram. While these outliers could strongly influence our model, even without those points there is still a general fan shape of the standardized residuals as the predicted sale price increases. The issue that this causes is that as our predicted price increases, the observed and expected error of our model increases. The higher predictions are less accurate than the lower predictions.

1. Let Y = sale price be the dependent or response variable. Use the OVERALL QUALITY variable as the explanatory variable (X) to predict Y. Fit a simple linear regression model using X to predict Y. Call this Model 2. You should:

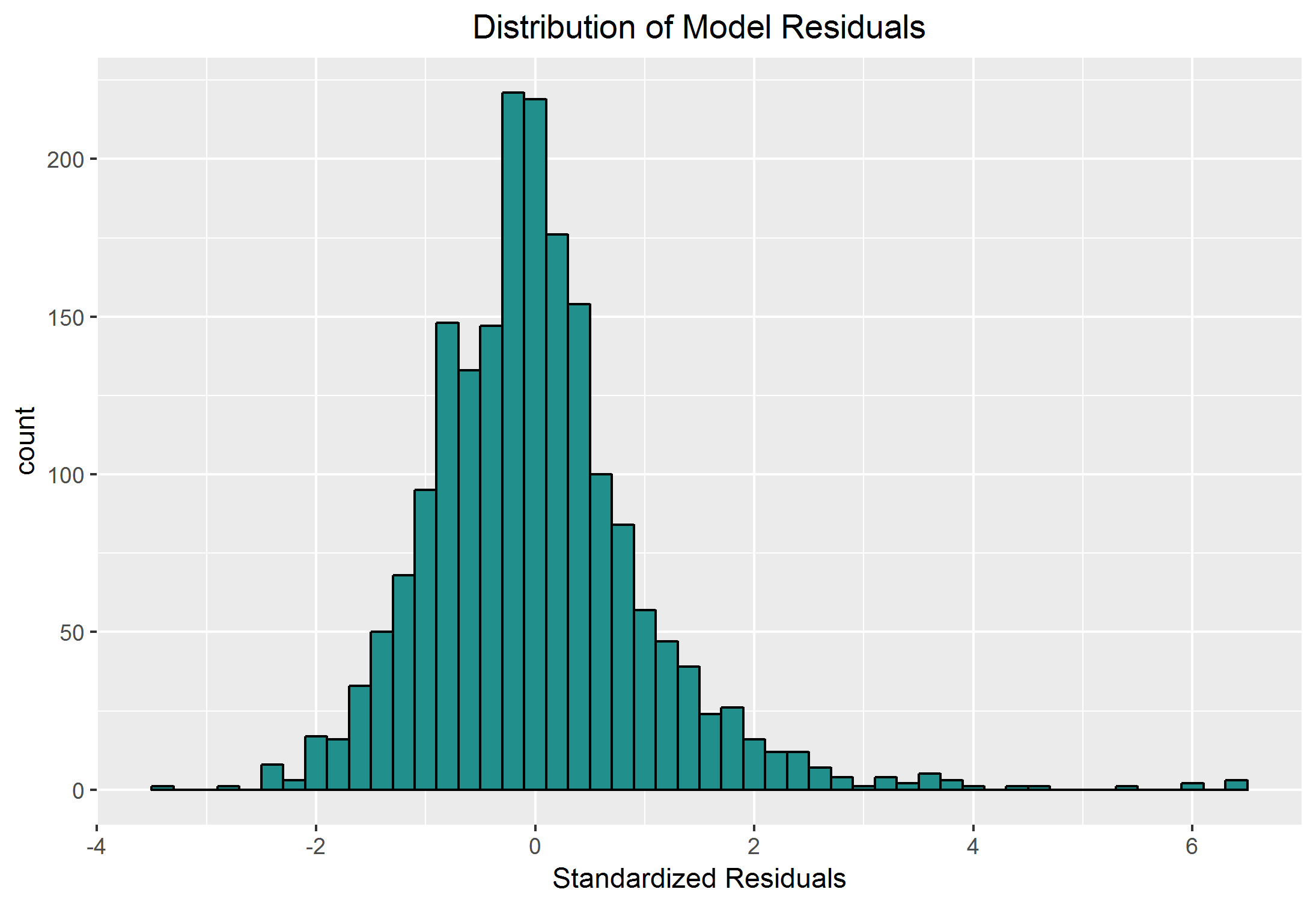


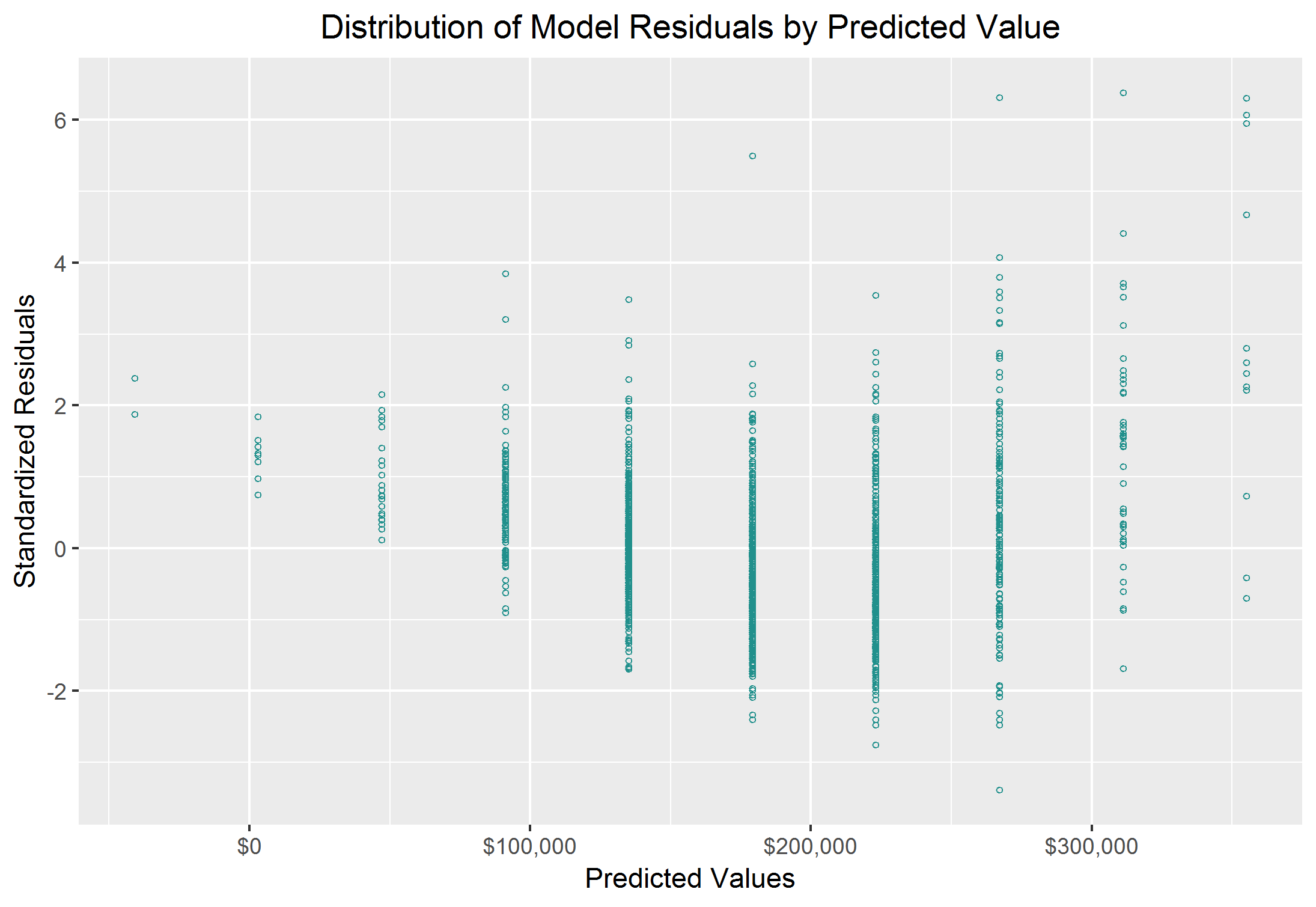
* 1. Y = 43997.254\*OverallQual - 84887.949
     + -84887.949: Our intercept is the value of a home that was rated a 0 in Overall Quality. This is outside of the realistic parameters as the lowest quality rating observed is 1. It simply serves as the y-intercept of the line of best fit.
     + 43997.254\*OverallQual: For every one point increase in Overall Quality, the predicted price increases by $43,997.25.
     + OverallQual is an ordinal variable, unlike TotalSqFt form model 1, which was totally continuous. Each level of Overall Quality has sale prices at many different values. For prediction purposes this poses a challenge because this model will assume that for a given Quality score each home will have the exact same sale price.
  2. R-Squared: 0.644
     + This model accounts for 64.4% of the variance in SalePrice.





* Intercept Hypothesis Test:
  + H0: β0 = 0
  + HA: β0 does not equal 0
  + Reject the null hypothesis at the 0 level
* OverallQual Hypothesis Test:
  + H0: β1 = 0
  + HA: β1 does not equal 0
  + Reject the null hypothesis at the 0 level
* Omnibus Hypothesis Test:
  + H0: All betas included in model (in our case only one) = 0
  + HA: At least one beta does not equal 0
  + We reject the null hypothesis and conclude that our model significantly explains the variance of SalePrice.



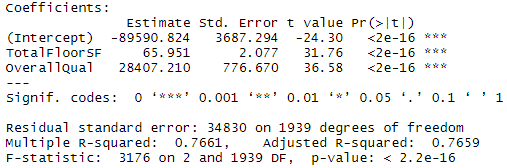


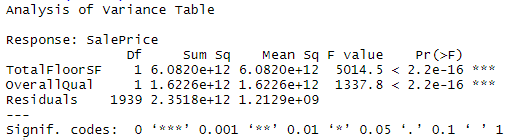
The residuals in the scatter plot seem to show a concave fanning pattern over the predicted sales price variable, where they trend more negative as the price increases until trending back positive over the last three quality levels. This shows a heteroscedastic nature for the residuals of this model as well. This histogram of the standardized residuals is right-tailed, which violates the normality of residuals assumption. There appear to be approximately five outlier results with highly positive standardized residuals and one with very negative standardized residual. These points could strongly affect the model.

1. Model 2 shows a better fit. It has an r-squared value about 4% greater than model 1. The t-statistic on the explanatory variable in model 2 is greater than that of model 1, which suggests a greater statistical significance for that explanatory variable.

*PART B: Multiple Linear Regression Models*

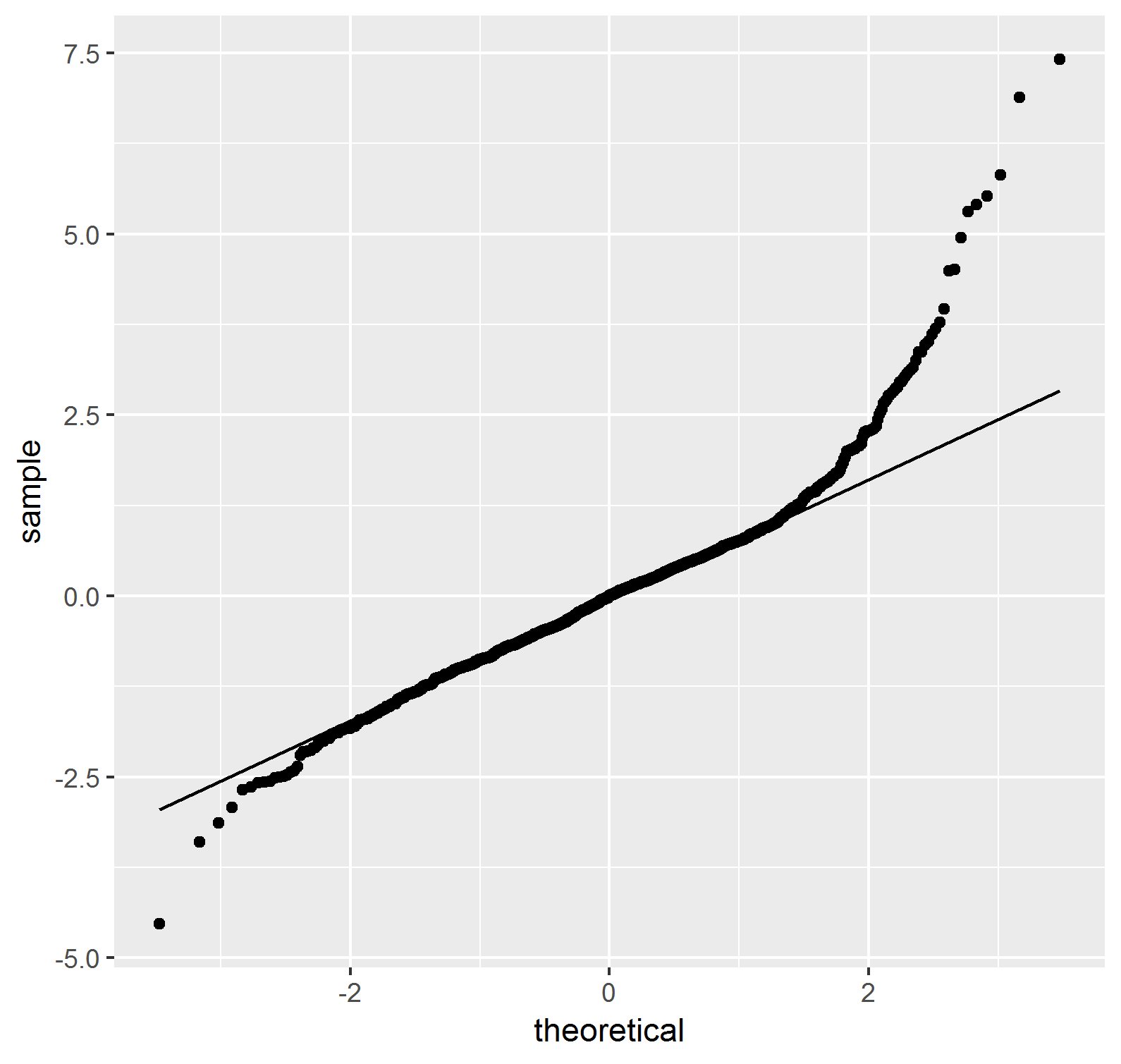
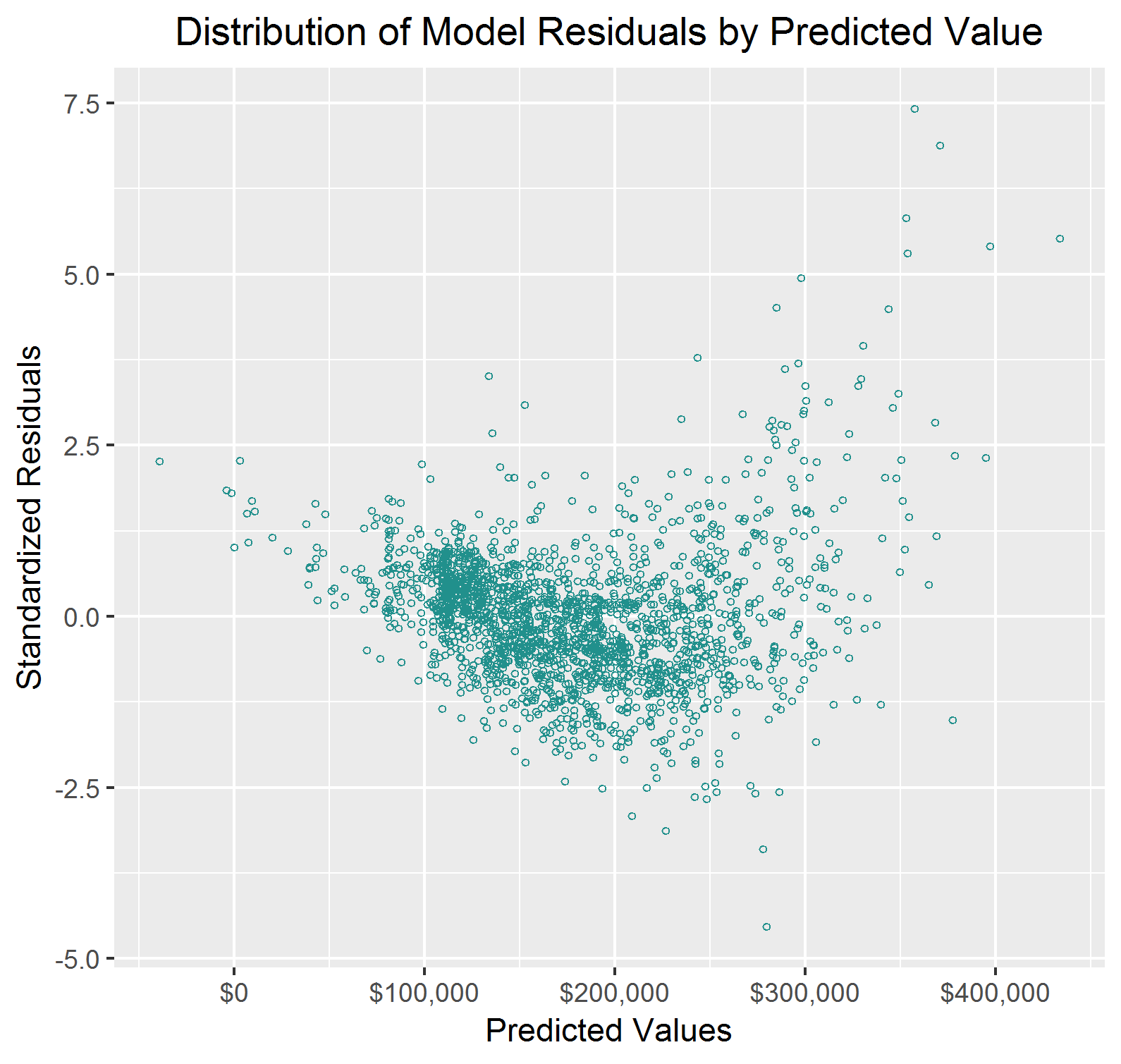
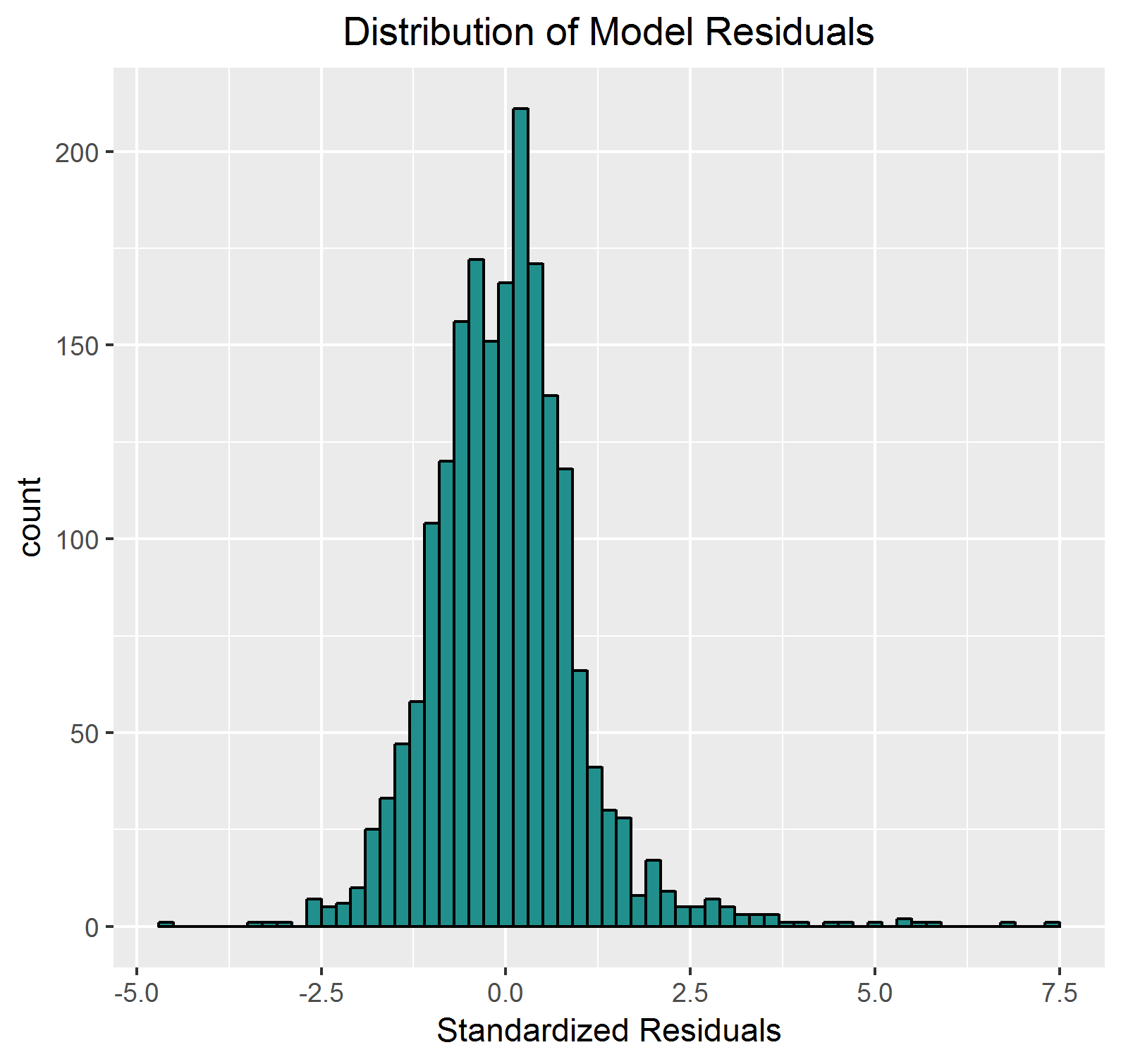
1. Fit a multiple regression model that uses 2 continuous explanatory (X) variables to predict Sale Price (Y). These two explanatory(X) variables should be: the explanatory variables from Model 1 and Model 2 above. Call this Model 3. You should:
   1. Y = 65.951\*TotalFloorSF + 28407.21\*OverallQual - 89590.824
      * -89590.824: Our intercept is the value of a home that was rated a 0 in Overall Quality and has zero total square footage. This is outside of the realistic parameters as the lowest quality rating observed is 1 and we do not have any empty plots of land in our sample. It simply serves as the y-intercept of the line of best fit.
      * 28407.21\*OverallQual: For every one point increase in Overall Quality while holding square footage constant, the predicted price increases by $28,407.21.
      * 65.951\*TotalFloorSF: For every increase of one square foot while holding the overall quality of the home constant, the predicted sale price increases by $65.95.
      * In this model both β1 and β2 are lower than they were in their respective simple linear models.
   2. R-Squared: 0.776
      * This model accounts for 76.6% of the variance in SalePrice.
      * This model fits better than either of the simple linear regressions. There is a 0.161 increase in r-squared from model 1 to model 3. That means that our multiple linear regression explains an extra 16% of sale price variance in comparison to the simple linear regression using only total square footage.





Specify the hypotheses associated with each coefficient of the model and the hypothesis for the omnibus model. Conduct and interpret the hypothesis tests. Intercept Hypothesis Test:

* Intercept Hypothesis Test:
  + H0: β0 = 0
  + HA: β0 does not equal 0
  + Reject the null hypothesis at the 0 level
* TotalFloorSF Hypothesis Test:
  + H0: β1 = 0
  + HA: β1 does not equal 0
  + Reject the null hypothesis at the 0 level
* OverallQual Hypothesis Test:
  + H0: β2 = 0
  + HA: β2 does not equal 0
  + Reject the null hypothesis at the 0 level
* Omnibus Hypothesis Test:
  + H0: β1 = β2 = 0
  + HA: At least one beta does not equal 0
  + We reject the null hypothesis and conclude that at least one βdoes not equal zero.



In the scatter plot for this model, it appears that we can still observe the concavity that we saw in the scatter plot for model 2. The extreme outliers in the histogram are also still present, which can also be seen in the Q-Q plot. There are still some extreme outliers affecting the model at the high end of our predicted sale price, however even with those removed it appears our model would violate the assumption of homoscedasticity.

* 1. Based on this information, we should retain both variables as predictor variables of Y. All of the current downfalls of model 3 are also more apparent in the simple linear models. Despite the homoscedasticity violations, the multiple linear regression model is a clear improvement over either simple linear model, which is plainly seen in the large increase in R-squared.

1. Select any other continuous variable you wish. Fit a multiple regression model that uses 3 continuous explanatory (X) variables to predict Sale Price (Y). These three variables should be your variable of choice plus the explanatory variables from Model 3. Call this Model 4. You should:
   1. Y = 58.69\*TotalFloorSF + 24004.561\*OverallQual + 74.186\*GarageArea - 86965.277
      * -86965.277: Our intercept is the value of a home that was rated a 0 in Overall Quality and has zero total square footage and no garage. This is outside of the realistic parameters as the lowest quality rating observed is 1 and we do not have any empty plots of land in our sample. It simply serves as the y-intercept of the line of best fit.
      * 74.186\*GarageArea: For every one square foot increase in the size of the garage while holding Overall Quality and house square footage constant, we predict an increase in sale price of $74.18.
      * 24004.561\*OverallQual: For every one point increase in Overall Quality while holding home and garage square footage constant, the predicted price increases by $24,004.56.
      * 58.69\*TotalFloorSF: For every increase of one square foot in home size while holding the overall quality of the home and garage size constant, the predicted sale price increases by $58.69.
      * In this model both β1 and β2 are lower than they were in their respective simple linear models and the previous multiple linear model.
   2. Report and interpret the R-squared value in the context of this problem. Does this multiple linear regression model fit better than the simple linear regression models? How do you know? Calculate the difference between R-squared for Model 4 and R-squared for Model 3. How would you interpret this difference? Does your variable of choice help to improve the model’s explanatory ability?
   3. Report the coefficient and ANOVA Tables. Specify the hypotheses associated with each coefficient of the model and the hypothesis for the omnibus model. Conduct and interpret the hypothesis tests.
   4. Check on the underlying assumptions. You can do this by hand, or use the provided results from one of the regression package functions, like lessR or CAR. Discuss any deviations from normality or patterns in the residuals that indicate heteroscedasticity. Do there appear to be outliers or points of concern?
   5. Based on this information, should you want to retain all three variables as predictor variables of Y? Discuss why or why not.

*PART C: Multiple Linear Regression Models on Transformed Response Variable*

1. Refit Model 1, Model 3 and Model 4 using the Natural Log of SALEPRICE as the response variable. This is LOG base e, or LN() on your calculator. You’ll have to find the appropriate function using R. Perform an analysis of goodness-of-fit to compare the Natural Log of SALEPRICE models to the original models. Which transformed model fits the best? Do the transformed models fit better than the original models? You do not need to report all of the output like was done in Parts A and B. Rather, you should construct a table to summarize your findings so that the comparisons can be made easily. What is the best way or statistic to use, to make comparisons between models? You may need more than one table to do this adequately, if you have more than 1 criteria.
2. How is the interpretation of the LN(SalePrice) models different from the SalePrice models? Discuss if the improvement of model fit justifies the use of the Log(SALEPRRICE) response variable, relative to interpretation and explanation to a non-technical audience, like your manager or other executives.

*PART D: Multiple Linear Regression and Influential Points*

1. Use Model 4 for this part. Even after you have cleaned your data, still you may have unusually large residuals, which you can see from the residual plots. These are called ‘influential’ points. Sometimes, we find that a small subset of ‘influential’ points exerts a disproportionate influence on the model coefficients. These points can be identified by several statistics such as DFFITS, Cook’s Distance, Leverage, and Influence. Fit Model 4 using a regression function from one of the comprehensive regression packages (like lessR). Obtain output data with these statistics (DFFITS, etc.) for individual records so that you can identify the influential points. Use the threshold value given in the text book (Like that on Page 112 of Chatterjee and Hadi). Then refit the model after removing the influential points. How many influential points did you find & remove? When you refitted the model, did the model improve? The other side of the coin is that if you remove data points due to them being “influential” and not looking like you might want them to look, some would argue that such an action is the modeler biasing the data. Comment on whether or not you find the improvement of model fit justifies the potential for the modeler biasing the result by removing potentially legitimate data points.

*PART E: Beginning to Think About a Final Model*

1. Use Model 4 to start with for this part. So far, we have fit a few models to predict SALEPRICE(Y). But, there are many other continuous variables in the data set. You could use theory, or your background knowledge, to select variables for inclusion in a multiple regression model. Many modelers do this. It gives a nice place to start the search process. On the technical side, in this assignment, we have been looking at change in R-squared when a new variable has been added to an existing model to isolate the explanatory contribution of that new variable. And, we have been looking at hypothesis tests on the individual coefficients.

Use the concept of Change in R-squared, plus anything else you wish, to put together a reasonable approach to find a good, comprehensive multiple regression model to predict SALEPRICE(Y). Any of the continuous variables can be considered fair game as explanatory variables. This can feel like an overwhelming task. You don’t need to go overboard, or kill yourself, in doing this. We will learn about automated approaches to do this shortly. But, for now, I’d like you to think about how you would do this by hand.

Use your approach to identify a good multiple regression model to predict SALEPRICE(Y) from the set of continuous explanatory variables available to you in the AMES dataset. For this task you need to:

1. Explain your approach
2. Report the model you determined and interpret the coefficients
3. Report the coefficient and ANOVA tables.
4. Report goodness of fit
5. Check on underlying model assumptions.

*CONCLUSION / REFLECTION*

Please write a conclusion / reflection section that, at minimum, addresses the questions:

* In what ways do variable transformation and outlier deletion impact the modeling process and the results?
* Are these analytical activities a benefit or do they create additional difficulties?
* Can you trust statistical hypothesis test results in regression?
* What do you consider to be next steps in the modeling process?

**Assignment Document:**

Results should be presented and discussed in an organized manner, preferably listed by task number and letter. The report should not contain unnecessary results or information. The document should be submitted in pdf format. Name your file Assignment2\_LastName.pdf.