Introduction:

Housing has always been seen as one of the major stepping stones in adulthood; people graduate college, get a job, start a family, and save enough money to buy a house. The question though has always been how much does it cost to buy a house and what factors into the price of a house. In this project, we looked into dataset from 1460 houses bought in Ames Iowa to create a regression model that best predicts the price of a house in Ames, Iowa. The variable of interest that we study is Sales Price and in our dataset we have eighty predictor variables that are utilized to predict the cost of a house. Of the eighty predictors, we have 23 nominal, 23 ordinal, 14 discrete, and 20 continuous and these range from everything from Total Plot Area to Fire Place and Pool. Our interest in this project is to select the most important variables to study and create a model that best predicts the Sales Price of a house. In evaluating our model, we will look into the bias of our model to the actual sales price, the maximal deviation, mean absolute deviation, and mean square error to conclude how accurately we created a model to predict the Sales Price. We will use 1060 observations in our training data set and compare our model to the 400 observations in the test data set to see how our modeled Sales Price compares to the actual Sales Price of the 400 observations.

From our dataset, we will look into normalizing the Sales Price by using the log function, and we will convert some of our predictors into dummy variables. From the list of variables, we will focus on several that we believe are highly correlated with SalesPrice, and then variable selection techniques also to see the maximum number of variables for predicting a highly accurate model without overfitting the data. The purpose is to create a model that can best predict the Sales Price from our validation data set, but also that could be used on other data sets and still get a good prediction.

Variable Selection:

When selecting our variables, we decided first to see which predictors would someone who was buying a house choose. The ones that stood out right away were Living Area, Bathroom, number of bedrooms, and total rooms. When most people speak about houses, one of the first things they mention is the number of bedrooms and bathrooms so we assumed those would be important factors in buying a house. For Living Area and total Basement Square Footage, we knew we did not need to use the 1st and 2nd floor breakdowns because they were added for total living area and total basement square footage. We also decided to create our own variable for bathrooms, by adding up basement half and full bathroom, and above ground half and full bathroom. The reason why we decided to create a new variable called total bathroom, was because we felt they each were important but we also just didn’t need four separate variables for bathroom.

Next we included garage area and garage cars because of location, Iowa is a state that most people drive in so there will be a need for cars. Also, Iowa snows regularly, so an enclosed space, such as a garage, would be very beneficial for whomever is buying the house. This factor also made us include heating quality because Iowa is known to get very cold in the winters. Next, we wanted to use Year Built as a variable, but there was so many different years that we decided to split it into two variables, old and new. If a house was built before 1950, it was considered old and if it was built after 1950, we considered it new. The reason we chose 1950 was because when we compared year built with sales price, we saw a huge increase in sale price after 1950.

The final variables we decided to use were external quality, neighborhood, building type, and overall quality. The external quality, neighborhood, building type, and overall quality were used because we assumed that a person who pays a lot of money for a house would want it to look nice. For our categorical variables, we decided to split them into dummy variables. In total we had thirteen variables chosen, but after making dummy variables, this number increased to \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. For sales price, we decided to normalize the data by taking the log and then converted it back to regular price by using the exponential after.