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NOVASTAR FINANCIAL INC
Form 8-K
May 15, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

May 9, 2007

Date of Report (Date of earliest event reported)

NOVASTAR FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Maryland	001-13533	74-2830661
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(State or other jurisdiction of incorporation or organization	(Commission File Number)	(I.R.S. Employer Identification No.)

8140 Ward Parkway, Suite 300, Kansas City, MO 64114

(Address of principal executive offices)
(Zip Code)

(816) 237-7000

(Registrant's telephone number, including area code)

Not Applicable

(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Section 1--Registrant's Business and Operations

Item 1.01 Entry into a Material Definitive Agreement.

Wachovia Whole Loan Master Repurchase Agreement

On May 9, 2007, Wachovia Bank, NA (together with its affiliates, "Wachovia"), NFI Repurchase Corporation, NMI Repurchase Corporation, HomeView Lending, Inc., NMI Property Financing, Inc., NovaStar Financial, Inc. (together with its affiliates, "NovaStar"), NFI Holding Corporation and NovaStar Mortgage, Inc. executed a Master Repurchase Agreement (2007 Whole Loan) (the "Whole Loan Facility" or "Agreement"), which provides financing to certain subsidiaries of NovaStar Financial, Inc. for the origination, purchase, and holding of certain eligible mortgage loans and residential real estate owned ("REO Properties"). The facility has a term of 364 days. Specific assets may be financed under this Agreement for 180 days, subject to extension up to 270 days for certain amounts and up to 364 days for certain reacquired or sub-performing loans and REO Properties. All obligations under the Agreement are guaranteed by NovaStar Financial, Inc., NFI Holding Corporation, NovaStar Mortgage, Inc. and HomeView Lending, Inc., and are secured by the mortgage loans financed under the Whole Loan Facility, servicing rights related to the mortgage loans financed under the Whole Loan Facility and by a pledge of the stock of certain special purpose subsidiaries of NovaStar holding REO Properties financed under the Agreement. In addition to the financing facilities described in this Current Report, Wachovia and certain of its affiliates routinely engage in other ordinary course financial transactions with NovaStar, including but not limited to acting as an underwriter for certain securitizations sponsored by NovaStar.

The amount available under this Agreement is \$1.9 billion, which amount will be reduced by the maximum aggregate purchase price and amounts advanced under certain other repurchase agreements expected to be executed between Wachovia and NovaStar. The various categories of mortgage loans and REO Properties that may be financed under the Whole Loan Facility are subject to additional sublimits based upon certain characteristics of the assets. The amounts outstanding under the Servicing Rights Facility and the Residual Securities Facility (each as defined below) will not reduce the amount outstanding under the Whole Loan Facility. The specific advance rate applicable to a particular asset depends on, among other matters, the type, age and performance of such asset and, in some cases, NovaStar Financial, Inc.'s level of liquidity. For recently originated mortgage loans under which there has been no delinquency in any of the first three monthly payments following origination, the advance rate under this Agreement is generally between 95% and 98% of the market value of such loan and such advances will bear interest at one-month LIBOR plus 0.65%. For other mortgage loans and REO Properties, the advance rate is generally between from 65% to 95% of market value, but may be lower pending Wachovia's review of a particular asset, and such advances bear interest at a rate ranging from one-month LIBOR plus 0.65% to one-month LIBOR plus 2%. In addition, advance rates for mortgage loans and REO Properties are subject to additional but similar limitations based upon the outstanding principal balance of the

mortgage loan or the appraised value of the REO Property and, in some cases, additional but similar limitations based upon NovaStar's valuation of the asset, cost, or committed sale price.

The market value of the assets will be determined by Wachovia in its sole discretion. If, in Wachovia's opinion, the market value of assets that are then

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financed under the Whole Loan Facility decreases for any reason, NovaStar will be required to repay the margin or difference in market value, or provide additional collateral.

NovaStar Mortgage will remain the servicer of the mortgage loans purchased by Wachovia under this Whole Loan Facility, provided Wachovia will have the right to replace NovaStar Mortgage as the servicer if the adjusted tangible net worth of NovaStar falls below a certain amount.

The Whole Loan Facility is cross-collateralized with all other repurchase and similar financing facilities between NovaStar and Wachovia, including the Servicing Rights Facility and the Residual Securities Facility (each as defined below). NovaStar will be required to pay Wachovia a structuring fee in connection with the Whole Loan Facility and certain additional fees and expenses, including but not limited to reimbursement of due diligence expenses and payment of certain fees in the event of voluntary prepayment or termination by NovaStar or the occurrence of an event of default. In addition, upon a change of control of NovaStar Financial, Inc., Wachovia has the right to terminate the Agreement and require the payment of a termination fee.

The Whole Loan Facility requires that the adjusted consolidated tangible net worth of NovaStar Financial, Inc. exceed both \$517 million (less the amount of required REIT dividends) and an amount equal to a portion of the value of various classes of assets held by NovaStar Financial, Inc. and its consolidated subsidiaries. In addition, NovaStar Financial, Inc. is required to maintain, on a consolidated basis, at least \$30 million of liquidity.

The Whole Loan Facility prohibits NovaStar Financial, Inc. from paying any dividends (other than dividends payable in stock), except for the payment of (i) dividends in the amounts and at the times necessary for NovaStar Financial, Inc. to comply with tax law requirements applicable to real estate investment trusts and (ii) dividends on NovaStar Financial, Inc.'s 8.90% Series C Cumulative Redeemable Preferred Stock and on the trust preferred securities issued by NovaStar Capital Trust I and NovaStar Capital Trust II. Absent the prior consent of Wachovia, permitted dividends may not be paid in cash. Dividends on the 8.90% Series C Cumulative Redeemable Preferred Stock and on the trust preferred securities can only be paid if after such payments NovaStar Financial, Inc. has \$30 million of liquidity. Further, dividends paid to enable NovaStar Financial, Inc. to comply with applicable tax requirements can be paid only in the form of notes, bonds, debentures, or common or preferred stock, and not in cash, except to the extent that the liquidity of NovaStar Financial, Inc. following payment in cash would exceed \$125 million or to the extent that payment in notes, bonds, debentures, or common or preferred stock would be financially impractical. Further, NovaStar cannot declare or pay a cash

dividend necessary pursuant to applicable tax laws more than 15 days before the date required by applicable tax law. As a real estate investment trust, NovaStar Financial, Inc. is required to declare dividends based on its 2006 taxable income before filing its 2006 tax return, which is due on September 15, 2007 and such dividends are required to be paid by December 31, 2007.

The Whole Loan Facility contains other customary affirmative and negative covenants, including but not limited to covenants prohibiting fundamental changes in the nature of the business of NovaStar, prohibiting sales by NovaStar of a material portion of its business or assets outside of the ordinary course of business, and prohibiting transactions between a NovaStar and any of its other affiliates that are not on arms-length terms.

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The Whole Loan Facility provides for certain additional events of default, including but not limited to the failure by NovaStar to make any payment due or to satisfy any margin call or to comply with any other material covenant (including financial covenants) or agreement under the Whole Loan Facility, representations or warranties made by NovaStar under the Whole Loan Facility and related agreements proving to be materially incorrect, certain cross defaults involving other contracts to which NovaStar is a party, an act of insolvency occurring with respect to any NovaStar entity, the failure by NovaStar to satisfy certain final non-appealable monetary judgments, regulatory enforcement actions that materially curtail the conduct of business by any NovaStar entity, and the occurrence of a material adverse change in the business, performance, assets, operations or condition of NovaStar Financial, Inc. and its consolidated subsidiaries taken as a whole.

If an event of default exists under the Whole Loan Facility, Wachovia has the right, in addition to other rights and remedies, to accelerate the repurchase and other obligations of NovaStar under the Whole Loan Facility and the related Guaranty, to cause all income generated by the purchased assets to be applied to the accelerated obligations, to terminate NovaStar Mortgage, Inc. as the servicer with respect to the purchased assets and transfer such servicing rights to a successor servicer, to sell or retain the purchased assets to satisfy obligations owed to it, and to recover any deficiency from NovaStar. In addition, an event of default under the Whole Loan Facility would cross-default all other financing facilities between NovaStar and Wachovia or any of its affiliates, and generally would permit Wachovia and its affiliates to set off any outstanding obligations of NovaStar against any collateral pledged by NovaStar to Wachovia or any of its affiliates under the Whole Loan Facility or under any other agreement. Further, NovaStar would be liable to Wachovia for all reasonable legal fees or other expenses incurred in connection with the event of default, the cost of entering into replacement transactions and entering into or terminating hedge transactions in connection or as a result of the event of default, and any other losses, damages, costs or expenses arising or resulting from the occurrence of the event of default.

The foregoing is a summary of the terms of the Whole Loan Facility and the related Guaranty. This summary is qualified in its entirety by reference to the full text of the

4

Whole Loan Facility and the related Guaranty, which are attached hereto as Exhibit 10.1 and 10.2, respectively, and are incorporated herein by reference.

Amendment Number One to Wachovia Master Repurchase Agreement (2007 Servicing Rights) and Amendment Number One to Wachovia Master Repurchase Agreement (Residual Securities)

On May 10, 2007, Wachovia Bank, N.A., Wachovia Capital Markets, LLC, NovaStar Mortgage, Inc., NovaStar Financial, Inc., NovaStar Holding Corporation and HomeView Lending Inc. executed Amendment Number One to the Master Repurchase Agreement (2007 Servicing Rights) (the "Servicing Rights Facility") dated as of April 25, 2007 (the "Servicing Rights Amendment"), and Wachovia Investment Holdings, LLC, Wachovia Capital Markets, LLC, NovaStar Mortgage, Inc., NovaStar Certificates Financing LLC and NovaStar Certificates Financing Corporation executed Amendment Number One to the Master Repurchase Agreement (Residual Securities) (the "Residual Securities Facility"), dated as of April 18, 2007 (the "Residual Securities Amendment" and together with the Servicing Rights Amendment, the "Amendments").

Under the Amendments, if NovaStar fails to satisfy any cash margin call under

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these facilities, Wachovia may increase the amounts outstanding under certain other facilities with Wachovia to satisfy such margin calls regardless of whether NovaStar could otherwise borrow such amount under such other facilities.

The Amendments also increase the amount of adjusted consolidated tangible net worth that NovaStar Financial, Inc. is required to maintain from \$400 million to \$517 million, (in each case, less the amount of required REIT dividends).

Finally, in addition to permitting the payment of dividends necessary for NovaStar Financial, Inc. to maintain its status as a REIT, subject to certain limitations, the Amendments permit the payment of dividends on NovaStar Financial, Inc.'s 8.90% Series C Cumulative Redeemable Preferred Stock and on trust preferred securities issued by NovaStar Capital Trust I and NovaStar Capital Trust II so long as after the payment of such dividends NovaStar Financial, Inc. would have at least \$30 million of liquidity and permit the payment of such dividends in cash only with the permission of Wachovia.

The Servicing Rights Agreement Amendment clarifies that the Service Rights Facility terminates on April 18, 2008, not April 24, 2008.

The foregoing is a summary of the terms of the Amendments. This summary is qualified in its entirety by reference to the full text of the Amendments, which are attached hereto as Exhibit 10.3 and 10.4, respectively, and are incorporated herein by reference.

Extensions of Existing Wachovia Facilities

On May 11, 2007, NovaStar entered into a short-term extension of two existing one-year Master Repurchase Agreements with Wachovia. One facility sets forth the terms under

5

which certain of NovaStar's subsidiaries may sell and Wachovia may purchase certain mortgage securities and the other sets forth the terms under which certain of NovaStar's subsidiaries may sell and Wachovia may purchase certain mortgage loans, in each case against an obligation of the relevant subsidiaries of NovaStar to repurchase the mortgage loans or mortgage securities purchased by Wachovia. The termination date of these facilities was extended to May 18, 2007.

Section 2--Financial Information

Item 2.03 Creation of a Direct Financial Obligation or an obligation under an Off-Balance Sheet Arrangement of a Registrant

See "Wachovia Whole Loan Master Repurchase Agreement" and "Amendment Number One to Wachovia Master Repurchase Agreement (2007 Servicing Rights) and Amendment Number One to Wachovia Master Repurchase Agreement (Residual Securities)" under Item 1.01 of this Current Report which are incorporated herein by reference.

Section 9---Financial Statements and Exhibits

Item 9.01 Financial Statements and Exhibits

(d) Exhibits. The following exhibits are filed herewith:

- 10.1 Master Repurchase Agreement (2007 Whole Loan), dated as of May 9, 2007, among Wachovia Bank, N.A., NFI Repurchase Corporation, NMI Repurchase Corporation, HomeView Lending, Inc., NMI Property

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Financing, Inc., NovaStar Financial, Inc., NFI Holding Corporation and NovaStar Mortgage, Inc.

- 10.2 Guaranty, dated as of May 9, 2007, among NovaStar Financial, Inc., NFI Holding Corporation, NovaStar Mortgage, Inc., HomeView Lending, Inc., and Wachovia Bank, NA.
- 10.3 Amendment Number One to Master Repurchase Agreement (2007 Servicing Rights), dated as of May 10, 2007 among Wachovia Bank, N.A., Wachovia Capital Markets, LLC, and NovaStar Mortgage, Inc.
- 10.4 Amendment Number One to Master Repurchase Agreement (Residual Securities), dated as of May 10, 2007 among Wachovia Investment Holdings, LLC, Wachovia Capital markets, LLC, NovaStar Mortgage, Inc. NovaStar Certificates Financing LLC and NovaStar Certificates Financing Corporation.

6

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DATE: May 15, 2007

NOVASTAR FINANCIAL, INC.
/s/ Gregory S. Metz

Gregory S. Metz
Chief Financial Officer

7

Exhibit Index

Exhibit Number

- 10.1 Master Repurchase Agreement (2007 Whole Loan), dated as of May 9, 2007, among Wachovia Bank, N.A., NFI Repurchase Corporation, NMI Repurchase Corporation, HomeView Lending, Inc., NMI Property Financing, Inc., NovaStar Financial, Inc., NFI Holding Corporation and NovaStar Mortgage, Inc.
- 10.2 Guaranty, dated as of May 9, 2007, among NovaStar Financial, Inc., NFI Holding Corporation, NovaStar Mortgage, Inc., HomeView Lending, Inc., and Wachovia Bank, NA.
- 10.3 Amendment Number One to Master Repurchase Agreement (2007 Servicing Rights), dated as of May 10, 2007 among Wachovia Bank, N.A., Wachovia

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Capital Markets, LLC, and NovaStar Mortgage, Inc.

- 10.4 Amendment Number One to Master Repurchase Agreement (Residual Securities), dated as of May 10, 2007 among Wachovia Investment Holdings, LLC, Wachovia Capital markets, LLC, NovaStar Mortgage, Inc. NovaStar Certificates Financing LLC and NovaStar Certificates Financing Corporation.