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NOVASTAR FINANCIAL INC
Form 8-K
May 03, 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

April 30, 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

(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

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Item 1.01 Entry into a Material Definitive Agreement.

Comprehensive Financing Facility Commitment Letter

On April 30, 2007, NovaStar Financial, Inc. (together with its affiliates, "NovaStar") and NovaStar Mortgage, Inc. ("NovaStar Mortgage") entered into a commitment letter (the "Commitment Letter") setting forth the terms of a commitment for a \$1.9 billion comprehensive financing facility arranged by Wachovia Capital Markets, LLC and certain of its affiliates ("Wachovia"). The facility would expand and replace the whole-loan and securities repurchase agreements currently existing between Wachovia and NovaStar, other than the Master Repurchase Agreement (2007 Servicing Rights), dated as of April 25, 2007 (the "Servicing Rights Facility") and the Master Repurchase Agreement (2007 Residual Securities) dated as of April 18, 2007 (the "Residual Securities Facility"). 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 proposed facility is expected to consist of the following separate agreements (collectively, the "Agreements"): (1) a Whole Loan Master Repurchase Agreement; (2) a Securities Master Repurchase Agreement (Investment Grade); (3) a Securities Master Repurchase Agreement (Non Investment Grade); (4) a Servicing Advance Master Repurchase Agreement; and (5) a Whole Loan Master Repurchase Agreement (New York). The aggregate purchase price under each individual Agreement will reduce availability under the other Agreements such that the maximum aggregate purchase price under all Agreements at any point in time will not exceed \$1.9 billion. Financing capacity under the proposed facility will be in addition to the aggregate \$100 million financing capacity under the Servicing Rights Facility and the Residual Securities Facility.

The Agreements will be cross-collateralized with each other and all other repurchase and similar financing facilities between NovaStar and Wachovia, including the Servicing Rights Facility and the Residual Securities Facility. NovaStar will be required to pay Wachovia a structuring fee in connection with the 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 Agreements and require the payment of a termination fee.

Whole Loan Master Repurchase Agreement

The Whole Loan Master Repurchase Agreement will provide 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 will have 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 aged or sub-performing loans and REO Properties. All obligations under the Agreement will be guaranteed by NovaStar, and will be secured by the mortgage loans financed under the Agreement and by a pledge of the stock of one or more special purpose subsidiaries of NovaStar Financial, Inc. holding REO Properties financed under the Agreement.

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The amount available under this Agreement will be limited only by the \$1.9 billion maximum aggregate purchase price and amounts advanced under the other Agreements, but various categories of mortgage loans and REO Properties will be subject to sublimits based upon certain characteristics of the assets. The specific advance rate applicable to a particular asset will depend 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 generally will be 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 will generally range from 65% to 95% of market value, but may be lower pending Wachovia's review of a particular asset, and such advances will 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 will be 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 Financial, Inc.'s valuation of the asset.

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 financed under the Agreement 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 Agreement, 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.

Securities Master Repurchase Agreement (Investment Grade)

The Securities Master Repurchase Agreement (Investment Grade) will provide financing for certain eligible investment grade mortgage securities, will have a sublimit of \$400 million, and will have a term of 364 days. All obligations under the Agreement will be

guaranteed by NovaStar, and will be secured by the mortgage securities financed under the Agreement and by a pledge of the stock of certain of NovaStar Financial Inc.'s subsidiaries.

The advance rate under this Agreement will be between 70% and 97% of the market value of the mortgage securities securing the advance, depending upon the rating assigned to the applicable mortgage security. The interest rate applicable to such advances will be equal to the commercial paper rate paid by an affiliate of Wachovia to fund the advances plus an amount ranging from 0% to 0.65%, depending on the rating assigned to the mortgage securities securing the advance.

The market value of the mortgage securities will be determined by Wachovia in its sole discretion. If, in Wachovia's opinion, the market value of mortgage securities that are then financed under the Agreement decreases for any reason, NovaStar will be required to repay the margin or difference in market value, or provide additional collateral.

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Securities Master Repurchase Agreement (Non-Investment Grade)

The Securities Master Repurchase Agreement (Non-Investment Grade) will provide financing for certain eligible non-investment grade mortgage securities, will have a sublimit of \$400 million, and will have a term of 364 days. All obligations under the Agreement will be guaranteed by NovaStar, and will be secured by the mortgage securities financed under the Agreement and by a pledge of the stock of certain of NovaStar Financial, Inc.'s subsidiaries.

The advance rate under this Agreement will be 65% of the market value of the mortgage securities securing the advance. The interest rate applicable to such advances will range from one-month LIBOR plus 1% to one-month LIBOR plus 2.5%, depending on the type of mortgage securities securing the advance.

The market value of the mortgage securities will be determined by Wachovia in its sole discretion. If, in Wachovia's opinion, the market value of mortgage securities that are then financed under the Agreement decreases for any reason, NovaStar will be required to repay the margin or difference in market value, or provide additional collateral.

Servicing Advance Master Repurchase Agreement

The Servicing Advance Master Repurchase Agreement will provide financing for certain eligible receivables of NovaStar Mortgage in respect of servicing advances made by NovaStar Mortgage under servicing agreements that permit the pledge of such receivables and are otherwise acceptable to Wachovia in its sole discretion. The Agreement will have a sublimit of \$75 million and will have a term of 364 days. The advance rate under this agreement will be between 85% and 90% of the amount of the applicable receivable, depending on the nature of the advance giving rise to the receivable. Such advances will bear interest at one-month LIBOR plus 1.25%.

Whole Loan Master Repurchase Agreement (New York)

The Whole Loan Master Repurchase Agreement (New York) will provide for borrowing capacity of \$1 million as required for certain regulatory purposes and will be substantially similar to the existing \$1 million master repurchase agreement between NovaStar Mortgage and Wachovia, but congruent with the terms and conditions of the other Agreements described above.

The closing of the facilities is subject to certain customary closing conditions, including but not limited to completion of definitive documentation, and receipt of approval from Wachovia's credit committee. There can be no assurance that the closing of the facility will occur. The parties expect that the definitive documentation for the facilities will contain customary representations and warranties, covenants and events of default that are consistent with those set forth in the Servicing Rights Facility and the Residual Securities Facility, including but not limited to covenants requiring NovaStar Financial, Inc. to maintain a certain minimum adjusted tangible net worth and a certain minimum amount of liquidity, and limiting NovaStar Financial, Inc.'s ability to pay dividends.

The Commitment Letter does not set forth all of the terms and conditions of the proposed Agreements; rather, it only summarizes the major points of understanding which will be the basis of the final repurchase agreements and

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related documents.

Waiver Under the Servicing Rights Facility and the Residual Securities Facility

On April 30, 2007, Wachovia Bank, N.A. and Wachovia Investment Holdings, LLC consented to NovaStar Financial, Inc. declaring and paying 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 for the quarter ended June 30, 2007, and waived certain breaches and any defaults under the Servicing Rights Agreement and the Residual Securities Agreement that may result from such payments. 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 foregoing is a summary of the terms of the waiver and is qualified in its entirety by reference to the full text of the waiver which is attached hereto as Exhibit 10.1, and is incorporated herein by reference.

This Current Report on Form 8-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, regarding management's beliefs, estimates, projections, and assumptions with respect to, among other things, NovaStar's future operations, business plans and strategies, as well as industry and market conditions, all of which are subject to change at any time without notice. Actual results and operations for any future period may vary materially from those discussed herein. Some important factors that could cause actual results to differ materially from those anticipated include: NovaStar's ability to generate and maintain sufficient liquidity on favorable terms; the size, frequency and structure of NovaStar's securitizations; NovaStar's ability to sell loans it originates in the marketplace;

impairments on NovaStar's mortgage assets; increases in prepayment or default rates on NovaStar's mortgage assets; increases in loan repurchase requests; inability of potential borrowers to meet NovaStar's underwriting guidelines; changes in assumptions regarding estimated loan losses and fair value amounts; finalization of the amount and terms of any severance provided to terminated employees; finalization of the accounting impact of NovaStar's previously-announced reduction in workforce; events impacting the subprime mortgage industry in general, including events impacting NovaStar's competitors and liquidity available to the industry; the initiation of margin calls under NovaStar's credit facilities; the ability of NovaStar's servicing operations to maintain high performance standards and maintain appropriate ratings from rating agencies; NovaStar's ability to generate acceptable origination volume while maintaining an acceptable level of overhead; residential property values; NovaStar's continued status as a REIT; interest rate fluctuations on NovaStar's assets that differ from NovaStar's liabilities; the outcome of litigation or regulatory actions pending against it or other legal contingencies; NovaStar's compliance with applicable local, state and federal laws and regulations or opinions of counsel relating thereto and the impact of new local, state or federal legislation or regulations or opinions of counsel relating thereto or court decisions on NovaStar's operations; NovaStar's ability to adapt to and implement technological changes; compliance with new accounting pronouncements; NovaStar's ability to successfully integrate acquired businesses or assets with NovaStar's existing business; the impact of general economic conditions; and the risks that are from time to time included in NovaStar's filings with the SEC,

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including NovaStar's Annual Report on Form 10-K for the year ended December 31, 2006. Other factors not presently identified may also cause actual results to differ. Words such as "believe," "expect," "anticipate," "promise," "plan," and other expressions or words of similar meanings, as well as future or conditional verbs such as "will," "would," "should," "could," or "may" are generally intended to identify forward-looking statements. This Current Report speaks only as of its date and NovaStar expressly disclaims any duty to update the information herein.

Item 9.01 Financial Statements and Exhibits

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

- 10.1 Waiver dated April 30, 2007, executed by Wachovia Bank, N.A. and Wachovia Investment Holdings, LLC.

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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.

NOVASTAR FINANCIAL, INC.

DATE: May 3, 2007

/s/ Gregory S. Metz

Gregory S. Metz
Chief Financial Officer

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Exhibit Index

<u>Exhibit Number</u>	<u>Description</u>
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- 10.1 Waiver dated April 30, 2007, executed by Wachovia Bank, N.A. and Wachovia Investment Holdings, LLC.

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