

NOVASTAR FINANCIAL INC

Form 424B5

May 29, 2003

Table of Contents

PROSPECTUS

Filed Pursuant to Rule 424(b)(5)

Registration Statement No. 333-104656

Direct Stock Purchase and Dividend Reinvestment Plan

300,000 Shares

NovaStar Financial, Inc.

Common Stock

**Please read this prospectus carefully before investing and
retain it for your future reference.**

We are offering existing holders of our common stock and new investors the opportunity to participate in our Direct Stock Purchase and Dividend Reinvestment Plan. The Plan is designed to be an economical and convenient method for existing stockholders to increase their holdings of our common stock and for new investors to make an initial investment in our common stock.

If you currently hold our common stock, you may elect to have all or a percentage of your cash dividends automatically invested in additional shares of common stock at a discount from the market price that may range from 0% to 3%, without payment of any brokerage commission or service charge. If you do not wish to participate in the Plan, you do not need to take any action, and you will continue to receive your cash dividends, if and when declared, as usual.

If you are either an existing holder of our common stock or a new investor, you may also purchase shares of common stock with optional cash payments of \$250 to \$5,000 per month at a discount determined by us each month and without payment of any brokerage commission or service

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charge. The discount may range from 0% to 3%. Optional cash payments in excess of the \$5,000 monthly limit require our prior approval.

Investing in our common stock involves risk. You should consider carefully the risk factors beginning on page 4 of this prospectus before enrolling in the Plan.

To ensure we qualify as a real estate investment trust, no person may own more than 9.8% of the outstanding shares of our common stock, unless our Board of Directors waives this limitation.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities issued under the Plan or have determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Our principal executive offices are located at 8140 Ward Parkway, Suite 300, Kansas City, Missouri 64114, telephone (816) 237-7000.

May 28, 2003

Table of Contents**PROSPECTUS TABLE OF CONTENTS**

	Page
<u>Forward-Looking Statements and Notice About Information Presented</u>	i
<u>Summary</u>	1
<u>Risk Factors</u>	4
<u>NovaStar Financial, Inc.</u>	7
<u>The Plan</u>	8
<u>Purpose</u>	8
<u>Available Options</u>	9
<u>Benefits and Disadvantages</u>	9
<u>Administration</u>	11
<u>Participation</u>	11
<u>Purchases and Prices of Shares</u>	14
<u>Account Statements</u>	19
<u>Dividends on Fractions</u>	19
<u>Certificates for Common Shares</u>	19
<u>Withdrawals and Termination</u>	19
<u>Other Information</u>	21
<u>Certain Federal Income Tax Consequences for Plan Participants</u>	22
<u>Federal Income Tax Considerations</u>	25
<u>Dividends</u>	32
<u>Use of Proceeds</u>	33
<u>Plan of Distribution</u>	33
<u>Where You Can Find More Information</u>	34
<u>Incorporation of Important Information by Reference</u>	35
<u>Legal Matters</u>	35
<u>Experts</u>	35

FORWARD-LOOKING STATEMENTS AND NOTICE ABOUT INFORMATION PRESENTED

This prospectus contains or incorporates by reference certain forward-looking statements. When used, statements which are not historical in nature, including the words anticipate, estimate, should, expect, believe, intend, and similar expressions are intended to identify forward-looking statements. These forward-looking statements are subject to risks and uncertainties, including, among other things, changes in interest rates on our mortgage assets and borrowings, changes in prepayment rates on our mortgage assets, general economic conditions, particularly as they affect the price of mortgage assets and the credit status of borrowers, and the level of liquidity in the capital markets, as it affects our ability to finance our mortgage asset portfolio.

Other risks, uncertainties and factors that could cause actual results to differ materially from those projected are detailed from time to time in reports filed by us with the Securities and Exchange Commission or SEC, including Forms 10-Q and 10-K.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in or incorporated by reference into this prospectus might not occur.

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You should rely only on the information contained in or incorporated by reference into this prospectus. We have not authorized any person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. The information in this prospectus is current as of the date such information is presented. Our business, financial condition, results of operations and prospects may have changed since such dates.

Table of Contents

SUMMARY

The following summary description of our Direct Stock Purchase and Dividend Reinvestment Plan is qualified by reference to the full text of the Plan which appears in this prospectus. Capitalized terms have the meanings given to them in the Plan.

Our Company

NovaStar Financial, Inc. is a Maryland corporation operating as a specialty finance company. We are self-advised and self-managed and carry out our business primarily through three separate but inter-related units mortgage lending, portfolio management and branch operations. We have elected to be taxed as a real estate investment trust or REIT since our tax year ending December 31, 1996. We distribute to our shareholders as dividends the mortgage payments we receive from our real estate loans and securities, less interest expense and operating costs.

Purpose of the Plan

The purpose of the Plan is to provide our existing stockholders and interested new investors with a convenient and less costly method of purchasing shares of our common stock and investing all or a percentage of their cash dividends in additional shares of our common stock. The Plan can also provide us with a means of raising additional capital through the direct sale of our common stock.

Source of Purchase of Shares

Shares of common stock purchased through the Plan will be purchased either directly from us as newly issued shares or Treasury shares or on the open market or through privately negotiated transactions, or by a combination of such purchases, at our option.

Investment Options

If you are eligible, you may begin participating in the Plan by completing an authorization form and returning it to the Plan Administrator. Brokers and nominees may reinvest dividends and make optional cash payments on behalf of beneficial owners. Enrollment in the Plan is entirely voluntary and you may terminate your participation at any time.

You may choose from the following options:

Full Dividend Reinvestment: The Plan Administrator will apply all cash dividends relating to all shares of common stock registered in your name and all cash dividends on all shares distributed to you under the Plan together with Optional Cash Payments, toward the purchase of additional shares of our common stock.

Partial Dividend Reinvestment: The Plan Administrator will apply the cash dividends on a percentage of common shares registered in your name specified by you to purchase additional shares of our common stock. The Plan Administrator will pay the dividends relating to the remaining shares of common stock to you in cash.

Optional Cash Payments Only: You will continue to receive cash dividends on shares of common stock registered in your name in the

Table of Contents

usual manner. You may make Optional Cash Payments to invest in additional shares of our common stock, subject to monthly minimums and maximums.

You may change your investment options at any time by requesting a new authorization form from the Plan Administrator and returning it to the Plan Administrator.

Optional Cash Payments

Each Optional Cash Payment is subject to a minimum purchase of \$250 and a maximum per month purchase limit of \$5,000. Optional cash payments in excess of \$5,000 require our prior approval.

Threshold Price

When pre-approved Optional Cash Payments in excess of \$5,000 are being used to purchase common stock from us, rather than in the open market, we may establish a Threshold Price which is the minimum price at which our common stock must trade on a given day during the Pricing Period to be included in the determination of the Market Price (as described below) for such investments. Your investment will be reduced, and $\frac{1}{10}$ th of your Optional Cash Payment will be returned to you without interest, for each trading day that does not meet the Threshold Price.

Maximum Price

As an investor in a pre-approved optional cash purchase that exceeds \$5,000, you may set a Maximum Price for such purchases if the stock is being acquired directly from us (and not through open market purchases). If the Market Price, less the applicable discount, exceeds the Maximum Price specified by you, no purchase shall be made and your Optional Cash Payment will be returned to you.

Cash Discounts

Each month, we may establish a discount between 0% and 3% from the Market Price applicable to Optional Cash Payments. The discount may vary each month but once established will apply uniformly to all purchases made using Optional Cash Payments under \$5,000 during that month. With respect to common stock purchased with reinvested dividends, the discount off the Market Price may range from 0% to 3%.

Investment Date

With respect to dividend reinvestment:

The Investment Date will be (i) if acquired directly from us, the dividend payment date declared by our Board of Directors, or (ii) in the case of open market purchases, the date or dates of actual investment, but no later than 10 business days, defined as any day other than Saturday, Sunday or legal holiday on which the New York Stock Exchange (NYSE) or another applicable securities exchange is closed or a day on which NovaStar Financial, Inc. or the Plan Administrator is authorized or obligated by law to close, following the dividend payment date.

Table of Contents

With respect to Optional Cash Payments:

The Investment Date is on or about the 21st day of each month or, in the case of open market purchases, some day or days between the 21st and the next 10 business days thereafter, as market conditions permit.

Price Whether the shares are acquired directly from us or on the open market, they will be purchased for the Plan at the applicable discount from the Market Price. In no event shall the amount of the discount plus brokerage commissions, if any, paid by us exceed 5% of the fair market value of our common stock on the date of purchase.

The Market Price, in the case of shares purchased directly from us, will be the average of the daily closing prices, computed to 3 decimal places, of our common stock on the NYSE, as reported on Bloomberg, during the Pricing Period. A Pricing Period is generally a period of 10 consecutive trading days.

In the case of shares purchased on the open market, the Market Price will be the weighted average of the actual prices paid, computed to 3 decimal places, for all of the common stock purchased by the Plan Administrator with all Participants' reinvested dividends or Optional Cash Payments for the related month.

Expenses With respect to shares of common stock purchased directly from us from reinvested dividends or Optional Cash Payments, we will pay expenses incurred in connection with such purchases. With respect to shares of common stock purchased in the open market, we will also pay brokerage commissions so long as the combined discount and brokerage commissions do not exceed 5% of the value of our common stock on the date of purchase. We will pay all other costs of administering the Plan. However, if you request that the Plan Administrator sell all or any percentage of your shares, you must pay a nominal fee per transaction to the Plan Administrator, any related brokerage commissions and applicable stock transfer taxes.

No Interest Pending Investment No interest will be paid on cash dividends or Optional Cash Payments pending investment or reinvestment under the terms of the Plan.

Withdrawal You may withdraw from the Plan with respect to all or a percentage of the shares held in your Plan account at any time by notifying the Plan Administrator in writing.

Amount Offered We are registering up to 300,000 shares of common stock authorized to be issued under the Securities Act of 1933, as amended (the Securities Act) for the Plan. Because we expect to continue the Plan indefinitely, we expect to authorize for issuance and register under the Securities Act additional shares from time to time as necessary for purposes of the Plan.

Table of Contents

RISK FACTORS

You should carefully consider the following factors and other information contained or incorporated by reference in this prospectus before deciding to purchase shares of our common stock.

We refer you to the discussion of risk factors set forth in our Annual Report on Form 10-K, which is incorporated by reference. That discussion addresses the following risks, among others:

Failure to renew or obtain adequate funding under warehouse facilities and repurchase agreements may harm our lending operations. We are currently dependent upon a limited number of primary credit facilities for funding of our mortgage loan originations and acquisitions. Any failure to renew or obtain adequate funding under these financing arrangements could harm our lending operations and our overall performance.

Our dependence upon borrowings can result in significant liquidity constraints. Our profitability is dependent upon our ability to borrow money on favorable terms. In October 1998, the subprime mortgage loan market faced a liquidity crisis with respect to the availability of short-term borrowings from major lenders and long-term borrowings through securitization. We faced significant liquidity constraints which harmed our business and our profitability.

Changes in interest rates may harm our results of operations. Our results of operations are likely to be harmed during any period of unexpected or rapid changes in interest rates. For example, a substantial or sustained increase in interest rates could harm our ability to acquire mortgage loans in expected volumes necessary to support our fixed overhead expense levels.

Financing with repurchase agreements may lead to margin calls if the market value of mortgage assets declines. We use repurchase agreements to finance the acquisition of mortgage assets in the short-term. In a repurchase agreement, we sell an asset and agree to repurchase the same asset at some period in the future. Generally, the repurchase agreements we entered into stipulate that we must repurchase the asset in 30 days. For financial accounting purposes, these arrangements are treated as secured financings. We retain the assets on our balance sheet and record an obligation to repurchase the asset. The amount we may borrow under these arrangements is generally 96% to 98% of the asset market value. When asset market values decrease, we are required to repay the margin, or difference in market value. To the extent the market values of assets financed with repurchase agreements decline rapidly, we will be required to meet cash margin calls. If cash is unavailable, we may be forced to default under the terms of the repurchase agreement. In that event, the lender retains the right to liquidate the collateral to settle the amount due from us.

Limited access to additional capital may ultimately curtail growth. Cash is required to fund loans we originate as financing arrangements allow us to borrow a percentage, typically 98%, of the mortgage note amount. If we are unable to obtain sufficient cash resources, we may not sustain asset growth.

Interest rate fluctuations may result in a decrease in net interest income. Interest rate fluctuations may harm our earnings as a result of potential changes in the spread between the interest rates on our borrowings and the interest rates on our mortgage assets. In addition, mortgage prepayment rates vary depending on such factors as mortgage interest rates and market conditions. Changes in anticipated prepayment rates may harm our earnings.

Failure to hedge effectively against interest rate changes may harm our results of operations. Asset/liability management hedging strategies involve risk and may not be effective in reducing our exposure to interest rate changes. Moreover, compliance with the REIT provisions of the Code may prevent us from effectively implementing the strategies that we determine, absent such compliance, would best insulate us from the risks associated with changing interest rates.

Table of Contents

Mortgage insurers may not pay claims resulting in increased credit losses or may in the future change their pricing or underwriting guidelines. We have placed reliance on mortgage insurance to mitigate the risk of credit losses. However there can be no assurance that the mortgage insurers will continue to have the financial ability to pay all claims presented. In addition, insurers have the right to deny a claim if the loan is not properly serviced or has been improperly originated. We also have the risk that mortgage insurance providers will revise their guidelines to such an extent that we will no longer be able to acquire coverage on our new production.

We face loss exposure due to the underlying real estate. A substantial portion of our mortgage assets consists of single family mortgage loans or mortgage securities evidencing interests in single family mortgage loans. Any material decline in real estate values would weaken our collateral loan-to-value ratios and increase the possibility of loss if a borrower defaults. In such event, we will be subject to the risk of loss on such mortgage assets arising from borrower defaults to the extent not covered by third-party credit enhancement.

Loans made to non-conforming mortgage borrowers entail relatively higher delinquency and loss rates. Lenders in the non-conforming mortgage banking industry make loans to borrowers who have impaired or limited credit histories, limited documentation of income and higher debt-to-income ratios than traditional mortgage lenders allow. Mortgage loans made to non-conforming mortgage loan borrowers generally entail a relatively higher risk of delinquency and foreclosure than mortgage loans made to borrowers with better credit and, therefore, may result in higher levels of realized losses. Any failure by us to adequately address the risks of non-conforming lending would harm our results of operations, financial condition and business prospects.

Current loan performance data may not be indicative of future results. Management uses estimates and assumptions based on actual experience with the mortgage loans. Actual results and the time of certain events could differ materially from those projected, due to factors including general economic conditions, fluctuations in interest rates, fluctuations in prepayment speeds, and fluctuations in losses due to defaults on mortgage loans. These fluctuations could rise to levels that would harm our profitability.

Market factors may limit our ability to acquire mortgage assets at yields that are favorable relative to borrowing costs. Despite management's experience in the acquisition of mortgage assets and its relationships with various mortgage suppliers, there can be no assurance that we will be able to acquire mortgage assets from mortgage suppliers which earn interest at rates greater than our cost of funds and at levels sufficient to maintain our profitability.

Intense competition in the non-conforming mortgage loan industry may result in reduced net income or in revised underwriting standards that would harm our operations. We face intense competition, primarily from commercial banks, savings and loans, other independent mortgage lenders, and other mortgage REITs. The government-sponsored entities Fannie Mae and Freddie Mac are also expanding their participation in the subprime mortgage industry. Any increase in the competition among lenders to originate or purchase nonconforming mortgage loans may result in either reduced interest income on such mortgage loans compared to present levels which may reduce net income or revised underwriting standards permitting higher loan-to-value ratios on properties securing non-conforming mortgage loans which may harm our operations.

Our failure to comply with federal, state or local regulation of mortgage lending, of broker compensation programs or of our local branch operations could harm our operations and profitability. As a mortgage lender, we are subject to many laws and regulations. Any failure to comply with these rules and their interpretations or with any future interpretations or judicial decisions could harm our profitability or cause a change in the way we do business. For example, several lawsuits have been filed challenging types of payments made by lenders to brokers, which payments are similar in type to the payments we make to our independent brokers. Similarly, in our branch operations, we allow our branch managers considerable autonomy which could result in greater exposure to third-party claims if our compliance programs are not strictly adhered to.

Table of Contents

Should we fail to maintain REIT status, we would be subject to tax as a regular corporation. If we fail to maintain our qualification as a REIT, we would be subject to federal income tax as a regular corporation.

We have a limited operating history and incurred significant net losses in 1999 and 1998. We have not yet developed an extensive earnings history or experienced a wide variety of interest rate or market conditions. Historical operating performance may be of limited relevance in predicting future performance. We incurred significant net losses in 1999 and 1998.

Restrictions on ownership of capital stock may inhibit market activity and the resulting opportunity for holders of our capital stock and warrants to receive a premium for their securities. In order for us to meet the requirements for qualification as a REIT, our charter generally prohibits any person from acquiring or holding, directly or indirectly, shares of common stock in excess of 9.8% of the outstanding shares. This restriction may inhibit market activity and the resulting opportunity for the holders of our common stock to receive a premium for their stock that might otherwise exist in the absence of such restrictions.

There is no assurance of an active public trading market. There is no assurance that an active public trading market for the common stock will be sustained. Our common stock's trading volume is relatively low compared to many other securities listed on the New York Stock Exchange.

Investors in our common stock may experience losses, volatility, and poor liquidity, and we may reduce our dividends in a variety of circumstances. Our earnings, cash flow, book value, and dividends can be volatile and difficult to predict. Investors should not rely on predictions or management beliefs. Although we seek to pay a regular common stock dividend rate that is sustainable, we may cut our dividend rate in the future for a variety of reasons. We may not provide public warnings of such dividend reductions prior to their occurrence. Fluctuations in our current and prospective earnings, cash flow, and dividends, as well as many other factors such as perceptions, economic conditions, stock market conditions, and the like, can affect our stock price. Investors may experience volatile returns and material losses. In addition, liquidity in the trading of our stock may be insufficient to allow investors to sell their stock in a timely manner or at a reasonable price.

The adoption of recently proposed tax legislation could negatively impact the attractiveness of REIT stock as an investment. Recently, President Bush introduced new tax proposals. The centerpiece proposal would exclude from an individual's taxable income all the dividends that he or she receives each year from corporations to the extent that the corporation has paid tax. This proposal will not apply to REIT dividends. The adoption of these or other proposals may reduce the appeal of REITs to investors. In such event, the value of your investment in us could be reduced significantly.

Table of Contents

NOVASTAR FINANCIAL, INC.

We are a specialty finance company that implements its business strategies primarily through three separate but inter-related units mortgage lending, portfolio management and branch operations.

Mortgage Lending

Our subsidiary, NovaStar Mortgage, Inc., originates conforming and non-conforming, single family, residential mortgage loans. NovaStar Mortgage has developed a nationwide network of wholesale loan brokers and mortgage lenders who submit mortgage loans to NovaStar Mortgage. Except for NovaStar Home Mortgage brokers described below, these brokers and mortgage lenders are independent from any of the NovaStar entities. NovaStar Mortgage underwrites these mortgage loans and funds approved mortgage loans through the use of its web-based underwriting systems used by customers for non-conforming residential mortgage loans.

We consider non-conforming borrowers to be individuals who have impaired or limited credit profiles or higher debt-to-income ratios than traditional mortgage lenders allow. These borrowers also include individuals who, due to self-employment or other circumstances, have difficulty verifying their income. These types of borrowers are generally willing to pay higher mortgage loan origination fees and interest rates than those charged by conventional lending sources. Because these borrowers typically use the proceeds of the mortgage loans to consolidate and refinance debt and to finance home improvements, education and other consumer needs, loan volume is generally less dependent on general levels of interest rates or home sales and therefore less cyclical than conventional mortgage lending.

Portfolio Management

Our portfolio management business is conducted at NovaStar Financial. We manage a long-term mortgage asset portfolio in a tax-advantaged real estate investment trust structure. Our portfolio consists of mortgage loans we acquire primarily from NovaStar Mortgage and mortgage securities we acquire from the securitization transactions of NovaStar Mortgage. We generally intend to hold our mortgage assets to maturity. Our mortgage loan purchases are financed primarily through long-term financing provided by issuing long-term structured debt securities. Our mortgage securities are generally financed initially with repurchase agreements and other short-term debt facilities, pending inclusion in long-term re-securitizations. We have adopted policies to mitigate the credit risk, interest rate risk and prepayment risk to which our mortgage asset portfolio is exposed. Earnings are generated from spread income on the mortgage loan and securities portfolio and from gains on sales of loans sold outright for cash or in securitization transactions.

Branch Operations

The third component in our business structure is our mortgage brokerage unit. NovaStar Home Mortgage, Inc. is a licensed mortgage broker with branch offices located throughout the United States. Each branch office is opened with a local retail mortgage broker acting as branch manager. The branch manager and his or her staff become employees of NovaStar Home Mortgage and are expected to operate pursuant to policies established by NovaStar Home Mortgage. Loans are brokered to investor/originators approved by NovaStar Home Mortgage, including NovaStar Mortgage. Fee income generated by the branch office is used to compensate the branch manager and staff and to pay a management fee to NovaStar Home Mortgage for providing administrative functions, including accounting, human resources, license/registration and loan investor management. We also benefit from any fee or other income that may be derived by NovaStar Mortgage in connection with loans

brokered to us by the branch offices.

In addition to these primary business units, we operate various fee based business units related to the residential lending industry, which provide title, settlement and credit services to borrowers.

Table of Contents

We have elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended. As a result, our earnings are generally not subject to federal income tax to the extent that we distribute our earnings to stockholders and maintain our qualification as a REIT. Novastar Mortgage and certain other of our subsidiaries are operated as taxable subsidiaries under the REIT tax rules. We believe this REIT structure is one of the most desirable for owning mortgage loans and mortgage securities and conducting mortgage operations. We are self-advised and self-managed. Our management oversees our day-to-day operations, subject to supervision by our Board of Directors. We do not need to rely on a third-party advisor to provide portfolio investment advice or a third-party manager for the day-to-day administration of our business operations. We believe that this is a structure that favorably distinguishes us from many other mortgage REITs.

NovaStar Financial, Inc., was incorporated in the State of Maryland on September 13, 1996 and began operations in December 1996. Our principal executive offices are located at 8140 Ward Parkway, Suite 300, Kansas City, Missouri 64114. Our telephone number is (816) 237-7000.

NFI Holding, Inc., our wholly-owned subsidiary, was incorporated in the State of Delaware on February 6, 1997. NFI Holding owns NovaStar Mortgage, Inc. and NovaStar Home Mortgage, Inc. NovaStar Mortgage was incorporated in the State of Virginia on May 16, 1996, though substantial operations did not commence until January 1997. NovaStar Home Mortgage was incorporated in the State of Delaware on May 25, 1998, though substantial operations did not commence until December 1999. Other consolidated subsidiaries are described in our annual report on Form 10-K which is incorporated by reference.

THE PLAN

The Direct Stock Purchase and Dividend Reinvestment Plan was adopted by our Board of Directors on January 29, 2003 and became effective on May 28, 2003.

The following series of questions and answers explains and constitutes the Plan in its entirety. Shareholders who do not participate in the Plan will receive cash dividends, as declared, and paid in the usual manner.

PURPOSE

1. What is the purpose of the Plan?

The primary purpose of the Plan is to provide eligible holders of shares of our common stock and interested new investors with a convenient and economical method of increasing their investment in us by investing cash dividends or Optional Cash Payments, or both, in additional shares of common stock without payment of any brokerage commission or service charge and, currently, at a discount ranging from 0% to 3% from the Market Price, as defined in Question 11.

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We may also use the Plan to raise additional capital through the sale each month of a portion of the shares available for issuance under the Plan to owners of shares and interested new investors (including brokers or dealers) who, in connection with any resales of such shares, may be deemed to be underwriters. Our ability to waive limitations applicable to the amounts which participants may invest pursuant to the Plan's Optional Cash Payment feature will allow for these sales.

Under the Plan, if you purchase shares directly from us, the net proceeds of the sale of those shares will be used to purchase additional mortgage assets and for general corporate purposes.

The Plan is intended for the benefit of our investors and not for individuals or investors who engage in transactions which may cause aberrations in the price or trading volume of shares of common stock. From time to time, financial intermediaries may engage in positioning transactions to benefit from the discount from the Market Price of the shares of common stock acquired through the reinvestment of dividends or Optional Cash

Table of Contents

Payments under the Plan. Those transactions may cause fluctuations in the price or trading volume of the shares of our common stock. We reserve the right to modify, suspend or terminate participation in the Plan by otherwise eligible holders of shares of common stock or interested new investors to eliminate practices which are, in our sole discretion, not consistent with the purposes or operation of the Plan or which adversely affect the price of the shares of common stock.

AVAILABLE OPTIONS

2. What options are available under the Plan?

Stock Purchase Program. Each month, you may elect to invest Optional Cash Payments in additional shares of common stock, subject to a minimum purchase of \$250 and a maximum per month purchase limit of \$5,000, subject to waiver. You may make Optional Cash Payments each month even if you do not reinvest dividends.

Dividend Reinvestment Program. Holders of our common stock who wish to participate in the Plan, whether Record Owners, Beneficial Owners, and interested new investors who make an initial investment through the Stock Purchase program described above, each a Participant, may elect to have all, a percentage, or none of their cash dividends paid on their shares of our common stock automatically reinvested in additional shares of common stock through the Dividend Reinvestment program. Cash dividends are paid on our common stock when and as declared by our Board of Directors, generally on a quarterly basis. Subject to the availability of shares of common stock registered for issuance under the Plan, there is no limitation on the amount of dividends you may reinvest under the dividend reinvestment feature of the Plan.

BENEFITS AND DISADVANTAGES

3. What are the benefits and disadvantages of the Plan?

Benefits

(a) The Plan provides you with the opportunity to automatically reinvest cash dividends paid on all or a percentage of your common stock in additional shares of common stock without payment of any brokerage commission or service charge and at a discount from the Market Price ranging from 0% to 3%.

(b) Whether you are an eligible stockholder or a new investor, the Plan provides you with the opportunity to make monthly investments of Optional Cash Payments, subject to minimum and maximum amounts, for the purchase of additional shares of common stock. If you purchase shares of common stock under the Optional Cash Payment program, you will not pay any brokerage commission or service charge, and your purchase price will be less a discount ranging from 0% to 3% from the Market Price.

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(c) All cash dividends paid on participants' Plan shares enrolled in the Dividend Reinvestment program can be fully invested in additional shares of common stock because the Plan permits fractional shares to be credited to Plan accounts. Dividends on such fractional shares, as well as on whole shares, will also be reinvested in additional shares which will be credited to Plan accounts.

(d) The Plan Administrator, at no charge to you and at your election, either sends certificates to you for optional shares purchased or provides for the safekeeping of stock certificates for shares credited to each Plan account.

Table of Contents

(e) As a participant in the Plan, you may also elect to deposit with the Plan Administrator certificates for your other common stock registered in your name for safekeeping without charge. Because you bear the risk of loss in sending certificates to the Plan Administrator, certificates should be sent by registered mail, return receipt requested, and properly insured to the address specified in Question 4 below. If certificates are later issued either upon your request or upon termination of your participation, new, differently numbered certificates will be issued.

(f) Periodic statements reflecting all current activity, including purchases, sales and latest balances, will simplify your record keeping.

Disadvantages

(a) Neither we nor the Plan Administrator will pay interest on dividends or Optional Cash Payments held pending reinvestment or investment. In addition, Optional Cash Payments of less than \$250 and that percentage of any Optional Cash Payment which exceeds the maximum monthly purchase limit of \$5,000, unless such upper limit has been waived by us, may be subject to return to you without interest. In addition, for pre-approved Optional Cash Payments in excess of \$5,000 used to purchase common stock directly from us, if the Threshold Price, if any, is not met or the Maximum Price you specified is exceeded, a portion or all of your Optional Cash Payments in excess of \$5,000 may be subject to return to you without interest.

(b) With respect to Optional Cash Payments, the actual number of shares to be issued to your Plan account will not be determined until after the end of the relevant Pricing Period. Therefore, during the Pricing Period you will not know the actual number of shares, if any, you have purchased.

(c) With respect to shares acquired from us, while the Plan will provide for a discount from the Market Price during the Pricing Period, the Market Price, as so discounted, may exceed the price at which shares of our common stock are trading on the Investment Date, when the shares are issued or thereafter. The trading price on the Investment Date generally governs the amount of taxable income to shareholders.

(d) Because Optional Cash Payments must be received by the Plan Administrator by the Optional Cash Payment Due Date, or one day before the relevant Pricing Period, such payments may be exposed to changes in market conditions for a longer period of time than in the case of typical secondary market transactions. In addition, Optional Cash Payments once received by the Plan Administrator will not be returned to you unless you send a written request to the Plan Administrator at least three business days before the Optional Cash Payment Due Date with respect to that payment.

(e) There is a nominal fee per transaction, a brokerage commission and applicable share transfer taxes on resales that you may be required to pay to the Plan Administrator if you request that the Plan Administrator sell some or all of your shares of common stock credited to your Plan account.

(f) If you chose to reinvest cash dividends, you will be treated for federal income tax purposes as having received a distribution in cash on the distribution payment date. You will have to use other funds (or sell a percentage of the common stock received) to fund the resulting tax liability.

Prospective investors should carefully consider the matters described in the Risk Factors section of the prospectus before making an investment in our common stock.

Table of Contents

ADMINISTRATION

4. Who Administers the Plan?

We have retained UMB Bank N.A., as the Plan Administrator, to administer the Plan, keep records, send statements of account activity, and perform other duties relating to the Plan. The mailing address, telephone number, website and email addresses are:

UMB Bank N.A.

Securities Transfer Division

928 Grand Boulevard, 13th Floor

Kansas City, Missouri 64106

Telephone (800) 884-4225

<http://www.umb.com/business/shareholder>

email: stock.transfer@umb.com

Certificates for Plan shares purchased pursuant to the Stock Purchase program but not designated for investment in the Dividend Reinvestment program will be sent to you or held by the Plan Administrator, at your discretion, free of charge. Plan shares designated for the Dividend Reinvestment program will be held by the Plan Administrator and registered in the Plan Administrator's name (or its nominee) as agent for each Participant in the Plan. As record holder for the Plan shares, the Plan Administrator will receive dividends on all Plan shares held on the dividend Record Date, will credit such dividends to Participants' accounts on the basis of whole or fractional Plan shares held in such accounts, and will automatically reinvest such dividends in additional shares of common stock according to the percentage of the Participants' shares of stock designated to reinvest. Any remaining percentage of cash dividends not designated for reinvestment will be sent to you. If the Plan Administrator resigns or otherwise ceases to act as Plan Administrator, we will appoint a new Plan Administrator to administer the Plan, and advise you of the change.

The Plan Administrator also acts as dividend disbursing agent, transfer agent, and registrar for our common stock.

PARTICIPATION

For purposes of this section, responses are generally directed (a) to existing shareholders, according to the method by which their shares are held, or (b) to investors who are not currently shareholders but would like to make an initial purchase of common stock to become a Participant.

5. Who is eligible to participate?

A Record Owner (which means a stockholder who owns shares of common stock in his or her own name) or a Beneficial Owner (which means a stockholder who beneficially owns shares of common stock that are registered in a name other than his or her own name, for example, in the name of a broker, bank, or other nominee) may participate in the Plan. A Record Owner may participate directly in the Plan. A Beneficial Owner must either become a Record Owner by having one or more shares transferred into his or her own name or coordinating with his or her broker, bank, or other nominee to participate in the Plan on his or her behalf. A broker, bank, or other nominee acting on behalf of a Beneficial Owner must have a separate account for each Beneficial Owner who is a Participant in the Plan and for whom it acts as the broker, bank, or other nominee. In addition, interested investors who are not stockholders may participate in the Plan through the Optional Cash Payment feature.

Table of Contents

We may terminate, by written notice, at any time, any Participant's participation in the Plan if that participation would or could be in violation of the restrictions contained in our Articles of Incorporation or By-laws. Those restrictions prohibit any person or group of persons from acquiring or holding, directly or indirectly, ownership of shares of our capital stock in excess of 9.8% (by number or value) of the outstanding shares. The meanings given to the terms "group" and "beneficial ownership" may cause a person who individually owns less than 9.8% of the shares outstanding to be deemed to be holding shares in excess of the foregoing limitation. Our Articles of Incorporation provide that in the event a person acquires shares of capital stock in excess of the foregoing limitation, the excess shares will be transferred to a trustee for the benefit of a charitable beneficiary designated by our Board of Directors. Under our Articles of Incorporation, certain transfers or attempted transfers that would jeopardize our qualification as a real estate investment trust for tax purposes may be void to the fullest extent permitted by law.

6. How does an eligible shareholder or interested new investor participate?

Record Owners may join the Plan by completing and signing an authorization form and returning it to the Plan Administrator. Authorization forms may be obtained at any time from the Plan Administrator.

Beneficial Owners who wish to join the Plan must instruct their bank, broker, or other nominee to arrange participation in the Plan on the Beneficial Owner's behalf. The bank, broker, or other nominee should then make arrangements with its securities depository and the securities depository will provide the Plan Administrator with the information necessary to allow the Beneficial Owner to participate in the Plan. Interested Beneficial Owners are cautioned to ensure that the broker, bank, or other nominee passes along the proceeds of any applicable discount to the beneficiary's account.

Alternatively, a Beneficial Owner may simply request that the number of shares the Beneficial Owner wishes to be enrolled in the Plan be reclassified or reregistered by the bank, broker, or other nominee in the Beneficial Owner's own name as Record Owner to directly participate in the Plan.

New investors may join the Plan as a Record Owner by making an initial investment in an amount of at least \$250 up to \$5,000, unless the maximum limit is specifically waived by us. The new investor should mark the box on the authorization form indicating that he or she is a new investor wishing to become a participant and should designate the amount for initial purchase of common stock. At the same time, the new participant may designate all, a percentage, or none of the dividends on shares purchased to be reinvested in additional shares. The authorization form should be returned to the Plan Administrator, with payment, on or before the applicable dates discussed below.

Any Participant who returns a properly executed authorization form to the Plan Administrator without specifying the number of shares to be included in the Dividend Reinvestment program will be enrolled as having selected the Full Dividend Reinvestment Option described below.

If an authorization form requesting reinvestment of dividends is received by the Plan Administrator at least 2 business days before the Record Date established for a particular dividend, reinvestment will commence with that dividend. If an authorization form is received less than 2 business days before the Record Date established for a particular dividend, the reinvestment of dividends will begin on the dividend payment date following the next Record Date if such stockholder or the participating bank, broker or other nominee is still a holder of record. Additionally, for Participants wishing to make Optional Cash Payments to purchase shares under the Stock Purchase program, full payment must be received by the Plan Administrator by the Optional Cash Payment Due Date. In the case of new investors making an initial investment to

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become Participants, both the authorization form and full payment of their designated initial investment must be received by the Optional Cash Payment Due Date.

Table of Contents

7. What does the authorization form provide?

The authorization form appoints the Plan Administrator as your agent and directs us to pay to the Plan Administrator your cash dividends on all or a specified percentage of shares of common stock that you own on the applicable Record Date. The authorization form directs the Plan Administrator to purchase for your account on the Investment Date additional shares of common stock with those dividends and Optional Cash Payments, if any, made by you. The authorization form also directs the Plan Administrator to reinvest automatically all, a percentage, or none of the subsequent dividends with respect to shares of common stock credited to your Plan account.

The authorization form provides for the purchase of initial or additional shares of common stock through the following investment options:

- (1) If you elect **Full Dividend Reinvestment**, the Plan Administrator will apply all cash dividends on all shares of common stock then or subsequently registered in your name, and all cash dividends on all shares of common stock credited to your Plan account, together with any Optional Cash Payments, toward the purchase of additional shares of common stock.

- (2) If you elect **Partial Dividend Reinvestment**, the Plan Administrator will apply all cash dividends on a specified percentage of shares of common stock that you own on the applicable Record Date registered in your name and specified on the authorization form, together with any Optional Cash Payments, toward the purchase of additional shares of common stock. The Plan Administrator will pay cash dividends on the remaining shares of common stock directly to you.

- (3) If you elect **Optional Cash Payments Only**, you will continue to receive cash dividends on shares of common stock in the usual manner. However, the Plan Administrator will apply any Optional Cash Payments that it receives from you toward the purchase of additional shares of common stock.

You may change your investment options at any time by requesting a new authorization form and returning it to the Plan Administrator at the address set forth in Question 4.

Any Participant who returns a properly executed authorization form to the Plan Administrator without electing an investment option will be enrolled as having selected the Full Dividend Reinvestment Option.

8. Is partial participation possible under the Plan?

Yes. New investors, Record Owners or the bank, broker, or other nominee for Beneficial Owners may designate any desired percentage of their shares for which dividends are to be reinvested. Dividends will thereafter be reinvested only on the percentage of shares specified, and the Record Owner or Beneficial Owner, as the case may be, will continue to receive cash dividends on the remainder of the shares.

9. When may an eligible shareholder or interested new investor join the Plan?

A Record Owner or a Beneficial Owner may join the Plan at any time. A new investor may join the Plan by making an initial investment of \$250 to \$5,000 (or more with our permission) when returning the authorization form. Once in the Plan, you remain in the Plan until you withdraw, we or the Plan Administrator terminate your participation or we terminate the Plan.

10. When will dividends and Optional Cash Payments be invested?

When shares are purchased from us, the Plan Administrator will make those purchases on the Investment Date in each month. Generally, the Investment Date will be the dividend payment date for dividends and the 21st day of a month for Optional Cash Payments, unless such date is not a business day in which case it is the 1st

Table of Contents

business day immediately thereafter, or, in the case of open market purchases, typically some day or days between the Investment Date and the next 10 business days thereafter, as market conditions permit.

When the Plan Administrator makes open market purchases, those purchases may be made on any securities exchange where the shares are traded, in the over-the-counter market or in negotiated transactions, and may be subject to such terms with respect to price, delivery, and other matters as agreed to by the Plan Administrator. Neither we nor you will have any authorization or power to direct the time or price at which the Plan Administrator purchases shares or the selection of the broker or dealer through or from whom the Plan Administrator makes purchases.

If the Plan Administrator receives the authorization form at least two days before the Record Date for a dividend payment, the election to reinvest dividends will begin with that dividend payment. If the Plan Administrator receives the authorization form less than two days before any such Record Date, reinvestment of dividends will begin on the dividend payment date following the next Record Date if you are still a stockholder of record.

The Plan Administrator will allocate shares and credit shares, computed to four decimal places, to your account as follows: (1) shares purchased from us will be allocated and credited as of the appropriate Investment Date; and (2) shares purchased in open market transactions will be allocated and credited as of the date on which the Plan Administrator completes the purchases of the aggregate number of shares to be purchased on behalf of all participants with dividends to be reinvested or Optional Cash Payments, as the case may be, during the month.

No interest will be paid on cash dividends pending investment or reinvestment under the terms of the Plan. Since no interest is paid on cash held by the Plan Administrator, it normally will be in your best interest to defer Optional Cash Payments until shortly before commencement of the Pricing Period.

PURCHASES AND PRICES OF SHARES

11. What will be the price to Participants of shares purchased under the Plan?

With respect to reinvested dividends whether the shares are acquired directly from us or on the open market, they will be purchased for the Plan at a discount from the Market Price, as defined below, ranging from 0% to 3%. We may establish the discount from the Market Price applicable to reinvested dividends on each corresponding dividend declaration date and will notify the Plan Administrator of the same. The discount may vary each declaration date but once established will apply uniformly to all dividends reinvested after each such corresponding declaration date.

Each month, we may establish a discount between 0% and 3% from the Market Price applicable to Optional Cash Payments. The discount may vary each month but once established will apply uniformly to all purchases made using Optional Cash Payments during that month.

However, in no event shall the amount of discounts specified above, plus any brokerage commissions, exceed 5% of the fair market value of the common stock on the date of purchase.

The Market Price, in the case of shares purchased directly from us, will be the average of the daily closing prices, computed to 3 decimal places, of our common stock on the NYSE, as reported on Bloomberg, during the Pricing Period (the 10 days on which the NYSE is open and for which trades in our common stock are reported immediately preceding the relevant Investment Date, or, if no trading occurs in our common stock on one or more of such days, for the 10 days immediately preceding the Investment Date for which trades are reported). In the case of shares purchased on the open market, the Market Price will be the weighted average of the actual prices paid, net of any brokerage commissions, computed to 3 decimal places, for all of the common stock purchased by the Plan Administrator with all Participants' reinvested dividends and Optional Cash Payments for the related month. The Internal Revenue Service has taken the position that for federal tax purposes the amount of the discount and the basis of the stock received are determined based on the market value of the stock on the

Table of Contents

investment date regardless of the mechanism that we actually employ to determine the number of shares purchased.

Neither we nor you will have any authorization or power to direct the time or price at which the Plan Administrator purchases shares or the selection of the broker or dealer through or from whom the Plan Administrator makes the purchases.

12. What are the Record Dates and Investment Dates for Dividend Reinvestment?

For the reinvestment of dividends, the Record Date is the date declared by our Board of Directors for payment of a dividend. Likewise, the dividend payment date declared by our Board of Directors constitutes the Investment Date applicable to the reinvestment of that dividend with respect to shares of common stock acquired directly from us, except that if any such date is not a business day, the first business day immediately following such date will be the Investment Date. The Investment Date with respect to shares of common stock that the Plan Administrator purchases in open market transactions will typically be some day or days between the 21st and the next 10 business days thereafter, as market conditions permit. Dividends will be reinvested on the Investment Date using the applicable Market Price.

13. How will the number of shares purchased for you be determined?

Your Plan account will be credited with the number of shares, including fractions computed to four decimal places, equal to the total amount to be invested on your behalf divided by the purchase price per share, less the applicable discount from the Market Price per share. The total amount to be invested will depend on the amount of any dividends paid on the number of shares of common stock that you own on the applicable Record Date and shares of common stock credited to your Plan account and available for investment on the related Investment Date, or the amount of any Optional Cash Payments made by you and available for investment on the related Investment Date. Subject to the availability of shares of common stock registered for issuance under the Plan, there is no limit to the number of shares available for issuance pursuant to the reinvestment of dividends.

14. What is the source of shares of common stock purchased under the Plan?

Shares of common stock credited to your Plan account will be purchased either directly from us, in which event such shares will be authorized but unissued shares or treasury shares, or on the open market or privately negotiated transactions, or by a combination of the foregoing, at our option, after a review of current market conditions and our current and projected capital needs. We will determine the source of the shares of common stock to be purchased under the Plan at least three business days before the relevant Record Date, in the event of a dividend, or Optional Cash Payment Due Date in the event of optional cash, and will notify the Plan Administrator of the same. Neither we nor the Plan Administrator will be required to provide any written notice to you as to the source of the shares of common stock to be purchased under the Plan, but information regarding the source of the shares of common stock may be obtained by contacting our investor relations department at (816) 237-7000.

15. How does the Optional Cash Payment feature of the Plan work?

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All Record Owners and interested new investors who have timely submitted signed authorization forms indicating their intention to participate in the Optional Cash Payment feature, and all Beneficial Owners whose brokers, banks, or other nominees have timely submitted signed authorization forms indicating their intention to participate in the Optional Cash Payment feature (except for Beneficial Owners whose brokers, banks, or other nominees hold the shares of the Beneficial Owners in the name of a major securities depository), are eligible to make Optional Cash Payments during any month, whether or not a dividend is declared. Optional cash payments must be accompanied by a remittance form. Each month the Plan Administrator will apply any Optional Cash Payment received from you no later than one business day before commencement of that month's Pricing Period to the purchase of additional shares of common stock for your account on the following Investment Date and will reinvest all, a percentage or none of the dividends on such shares as directed on the authorization form.

Table of Contents

The Optional Cash Discount is the discount from the Market Price applicable to Optional Cash Payments and such discount will be established each month by us and will range between 0% and 3% of the Market Price, subject to an overall maximum discount of 5% (including the discount on shares acquired through reinvested dividends) for participants in the Dividend Reinvestment Plan who also make optional cash purchases. The Company may limit the amount of optional cash purchases by a participant in the dividend reinvestment plan to assure compliance with the requirement of a maximum discount of 5%.

16. What limitations apply to Optional Cash Payments?

Each Optional Cash Payment is subject to a minimum purchase of \$250 and a maximum per month purchase limit of \$5,000. Generally, Optional Cash Payments of less than \$250 and that portion of any Optional Cash Payment which exceeds the maximum monthly purchase limit of \$5,000, unless such limit has been waived by us, will be returned to you without interest at the end of the relevant Pricing Period.

You may make Optional Cash Payments of up to \$5,000 each month without our prior approval, subject to our right to modify, suspend or terminate participation in the Plan by otherwise eligible holders of shares of common stock or interested new investors to eliminate practices which are, in our sole discretion, not consistent with the purposes or operation of the Plan or which adversely affect the price of the shares of common stock. Optional cash payments in excess of \$5,000 may be made by you only upon our acceptance of a completed Request for Waiver form from you and the Plan Administrator's receipt of that form. There is no pre-established maximum limit applicable to Optional Cash Payments that may be made pursuant to accepted Requests for Waivers. A Request for Waiver form must be received each month by us and accepted by us and notice of our acceptance must have been received by the Plan Administrator no later than the Optional Cash Payment Due Date, as defined in Question 17, for the applicable Investment Date. Request for Waiver forms will be furnished at any time upon request to the Plan Administrator at the address or telephone number specified in Question 4. Requests for Waivers will be accepted only with respect to actual Record Owners and not for the benefit of Beneficial Owners or multiple Participants. If you are interested in obtaining further information about a Request for Waiver, you should contact our investor relations department at (816) 237-7000.

Waivers will be considered on the basis of a variety of factors, which may include our current and projected capital needs, the alternatives available to us to meet those needs, prevailing market prices for shares of common stock and our other securities, general economic and market conditions, expected aberrations in the price or trading volume of the shares of common stock, the potential disruption of the price of the shares of common stock by a financial intermediary, the number of shares of common stock that you hold, your past actions under the Plan, the aggregate amount of Optional Cash Payments for which such waivers have been submitted and the administrative constraints associated with granting such waivers. Grants of waivers will be made in our absolute discretion.

You are not obligated to participate in the Optional Cash Payment feature of the Plan. Optional cash payments need not be in the same amount each month.

Unless we waive our right to do so, we may establish for any Pricing Period a minimum Threshold Price applicable only to the investment of Optional Cash Payments that exceed \$5,000 and that are made pursuant to Requests for Waivers, to provide us with the ability to set a minimum price at which shares of common stock will be sold under the Plan each month pursuant to such requests. A Threshold Price will only be established when shares of common stock will be purchased directly from us on the applicable Investment Date. We will, at least three business days before each Optional Cash Payment Due Date, determine whether to establish a Threshold Price and, if a Threshold Price is established, its amount and so notify the Plan Administrator. The determination whether to establish a Threshold Price and, if a Threshold Price is established, its amount, will be made by us at our discretion after a review of current market conditions, the level of participation in the Plan, and our current and projected capital needs. Neither we nor the Plan Administrator will be required to provide any written notice to you as to whether a

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Threshold Price has been established for any Pricing Period, but information regarding the Threshold Price may be obtained by contacting us at (816) 237-7000.

Table of Contents

The Threshold Price, if any, for Optional Cash Payments made through Requests for Waivers, if established for a Pricing Period, will be a stated dollar amount that the average of the closing prices of the shares of common stock on the New York Stock Exchange during the Pricing Period must equal or exceed. In the event that the Threshold Price is not satisfied for a trading day in the Pricing Period, then the trading price for such day will be excluded from the computation of the Market Price for such period and the investment made on the corresponding Investment Date will be reduced. For each trading day on which the Threshold Price is not satisfied, ¹/₁₀th of each Optional Cash Payment made by you pursuant to a Request for Waiver will be returned to you, without interest, as soon as practicable after the end of the applicable Pricing Period. Thus, for example, if the Threshold Price is not satisfied for three of the ten trading days in a Pricing Period, ³/₁₀th of your Optional Cash Payment made pursuant to a Request for Waiver will be returned to you by check, without interest, as soon as practicable after the end of the applicable Investment Date. The Plan Administrator expects to mail such checks within five to ten business days from the end of the applicable Investment Date. This return procedure will only apply when shares are purchased directly from us for Optional Cash Payments made through Requests for Waivers and we have set a Threshold Price with respect to the relevant Pricing Period.

Setting a Threshold Price for a Pricing Period will not affect the setting of a Threshold Price for any subsequent Pricing Period. The Threshold Price concept and return procedure discussed above apply only to Optional Cash Payments made through Requests for Waivers.

For any Pricing Period, we may waive our right to set a Threshold Price for Optional Cash Payments made through Requests for Waivers. You may ascertain whether the Threshold Price applicable to a given Pricing Period has been set or waived, as applicable, by contacting us at (816) 237-7000.

Likewise, your Optional Cash Payments made pursuant to a Request for Waiver may specify a Maximum Price per share that you are willing to pay and if the Market Price less the applicable discount exceeds such Maximum Price, and the stock is to be purchased directly from us and not on the open market, your investment will not be made and your full payment will instead be returned to you without interest.

Each month, at least three business days before the applicable Optional Cash Payment Due Date, we may establish the discount from the Market Price applicable to Optional Cash Payments during the corresponding Pricing Period and will notify the Plan Administrator of the same. The discount may be between 0% and 3% of the Market Price and may vary each month, but once established will apply uniformly to all Optional Cash Payments made during that month. The discount will be established in our sole discretion after a review of current market conditions, the level of participation in the Plan, and our current and projected capital needs. The discount applies only to Optional Cash Payments. Neither we nor the Plan Administrator will be required to provide any written notice to you as to the discount, but information regarding the discount applicable to the next Pricing Period may be obtained by contacting us at (816) 237-7000. Setting a discount for a Pricing Period will not affect the setting of a discount for any subsequent Pricing Period.

17. What are the Due Dates and Investment Dates for Optional Cash Payments?

Optional cash payments will be invested every month on the related Investment Date. The Optional Cash Payment Due Date is one business day before commencement of the related Pricing Period and the Investment Date is on or about the 21st day of each month or, in the case of open market purchases, the Investment Date will be some day or days between the 21st and the next 10 business days thereafter, as market conditions permit.

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Optional cash payments that the Plan Administrator receives by the Due Date will be applied to the purchase of shares of common stock on the Investment Dates which relate to that Pricing Period. No interest will be paid by us or the Plan Administrator on Optional Cash Payments held pending investment. Generally, Optional Cash Payments received after the Due Date will be returned to you without interest at the end of the Pricing Period; you may resubmit those Optional Cash Payments before commencement of the next or a later Pricing Period.

For a schedule of expected Optional Cash Payment Due Dates and Investment Dates, visit our website at <http://www.novastaris.com>.

Table of Contents

18. When must the Plan Administrator receive Optional Cash Payments?

Each month the Plan Administrator will apply any Optional Cash Payment for which good funds are timely received to the purchase of shares of common stock for your account during the next Pricing Period. For funds to be invested during the next Pricing Period, the Plan Administrator must have received a check, money order or wire transfer by the end of the business day immediately preceding the first trading day of the ensuing Pricing Period and that check, money order or wire transfer must have cleared on or before the first Investment Date in such Pricing Period. Wire transfers may be used only if the Plan Administrator approves it verbally in advance. Checks and money orders are accepted subject to timely collection as good funds and verification of compliance with the terms of the Plan. Checks or money orders should be made payable to UMB Bank N.A. and submitted together with, initially, the authorization form or, subsequently, the form for additional investments attached to your statements. Checks returned for any reason will not be resubmitted for collection. A fee will be charged for each returned check.

No interest will be paid by us or the Plan Administrator on Optional Cash Payments held pending investment. Since no interest is paid on cash held by the Plan Administrator, it normally will be in your best interest to defer Optional Cash Payments until shortly before commencement of the Pricing Period.

For payments to be invested on the first Investment Date in a Pricing Period, in addition to the receipt of good funds by the first Investment Date in a Pricing Period, the Plan Administrator must be in receipt of an authorization form as of the same date.

19. May Optional Cash Payments be returned?

Yes. Upon telephone or written request to the Plan Administrator received at least three business days before the Optional Cash Payment Due Date for the Investment Date with respect to which Optional Cash Payments have been delivered to the Plan Administrator, such Optional Cash Payments will be returned to you as soon as practicable. Requests received less than three business days before such date will not be returned but instead will be invested on the next related Investment Date. Additionally, in the case of shares being purchased from us, 1/10 of each Optional Cash Payment will be returned by check, without interest, as soon as practicable after the end of the Pricing Period for each trading day that does not meet the Threshold Price, if any, applicable to Optional Cash Payments made pursuant to Requests for Waivers. Similarly, if the Market Price less any applicable discount exceeds the requested Maximum Price, all your waiver request funds will be returned. Also, each Optional Cash Payment, to the extent that it does not either conform to the limitations, or clear within the time limits, described above, will be subject to return to you as soon as practicable.

20. Is automatic monthly investment of Optional Cash Payments available under the Plan?

You can automatically invest a specified monthly amount (not less than \$250 and not more than \$5,000 per month) deducted directly from your U.S. bank account by completing the automatic monthly deduction section on the enrollment form and returning it to the Plan Administrator. Funds will be transferred from your account three business days prior to the Optional Cash Payment Due Date each month. You can change or stop automatic monthly investments by completing and returning a new automatic monthly deduction section on the enrollment form or by sending written notification to the Plan Administrator. The Plan Administrator must receive your instructions and authorization ten business days prior to the monthly Optional Cash Payment Due Date.

21. Are there any expenses to you in connection with your participation under the Plan?

No. You will incur no brokerage commissions or service charges in connection with the reinvestment of dividends and in connection with all purchases made pursuant to Optional Cash Payments under the Plan. We will pay all other costs of administration of the Plan. Additionally, you may elect to send the certificates for your other shares of common stock to the Plan Administrator for safekeeping, and there is no fee for this service. However, should you request that the Plan Administrator sell all or any percentage of your shares you may pay a nominal fee per transaction to the Plan Administrator, any related brokerage commissions, and applicable stock transfer taxes.

Table of Contents

ACCOUNT STATEMENTS

22. What kind of reports will be sent to you?

You will receive a statement of your account following each purchase or sale transaction and following any withdrawal of shares. These statements are your continuing record of the cost of your purchases and should be retained for income tax purposes. In addition, you will receive copies of other communications sent to holders of the shares of common stock, including our annual report to stockholders, the notice of annual meeting and proxy statement in connection with our annual meeting of stockholders, and Internal Revenue Service information for reporting dividends paid.

DIVIDENDS ON FRACTIONS

23. Will you be credited with dividends on fractions of shares?

Yes.

CERTIFICATES FOR COMMON SHARES

24. Will certificates be issued for shares purchased?

No. Shares of common stock purchased for you will be held in the name of the Plan Administrator or its nominee. No certificates will be issued to you for shares in the Plan unless you submit a written request to the Plan Administrator or until participation in the Plan is terminated. At any time, you may request that the Plan Administrator send you a certificate for some or all of the whole shares credited to your account. You should mail this request to the Plan Administrator at the address set forth in the answer to Question 4. Any remaining whole shares and any fractions of shares will remain credited to your Plan account. Certificates for fractional shares will not be issued under any circumstances.

25. In whose name will certificates be registered when issued?

Your Plan account is maintained in the name in which your certificates were registered at the time of your enrollment in the Plan. Share certificates for whole shares purchased under the Plan will be similarly registered when issued upon your request. If you are a Beneficial Owner, you should place the request through your banker, broker, or other nominee. If you wish to pledge shares credited to your Plan account, you must first withdraw those shares from the Plan account. If you wish to withdraw your shares and have any or all of the full shares held in their Plan account issued and delivered to you in physical form, you may do so by sending a written instruction to the Plan Administrator.

Registration of withdrawn shares in a name other than yours will require the guaranty of your signature.

WITHDRAWALS AND TERMINATION

26. When may participants withdraw from the Plan?

You may withdraw from the Plan with respect to all or a portion of the shares held in your Plan account at any time. If the request to withdraw is received before an ex-dividend date, the request will be processed within three business days following the Plan Administrator's receipt of the request.

If the Plan Administrator receives your request to withdraw on or after an ex-dividend date, but before a payment date, the Plan Administrator, in its sole discretion, may either pay such dividend in cash or reinvest it in shares for your account. The request for withdrawal will then be processed as promptly as possible following

Table of Contents

such dividend payment date. All dividends subsequent to such dividend payment date or Investment Date will be paid in cash unless you re-enroll in the Plan, which may be done at any time.

Any Optional Cash Payments which have been sent to the Plan Administrator before a request for withdrawal will also be invested on the next Investment Date unless you expressly request return of that payment in the request for withdrawal, and the Plan Administrator receives the request for withdrawal at least five business days before the Optional Cash Payment Due Date with respect to which Optional Cash Payments have been delivered to the Plan Administrator.

27. How do you withdraw from the Plan?

If you wish to withdraw from the Plan with respect to all or a portion of the shares held in your Plan account, you must notify the Plan Administrator in writing at its address set forth in the answer to Question 4. Upon your withdrawal from the Plan or termination of the Plan by us, certificates for the appropriate number of whole shares credited to your account under the Plan will be issued. Registration of withdrawn shares in a name other than yours will require the guaranty of your signature.

Upon withdrawal from the Plan, you may also request in writing that the Plan Administrator sell all or part of the shares credited to your Plan account. The Plan Administrator will sell the shares as requested within ten business days after processing the request for withdrawal. The timing and price of the sale are at the sole discretion of the Plan Administrator. The Plan Administrator will send a check for the proceeds of the sale, less any brokerage commissions and service charges paid to the Plan Administrator and any applicable share transfer taxes, generally within five business days of the sale.

Cash will be paid in lieu of any fraction of a share, based on the prevailing market price.

28. Are there any automatic termination provisions?

Yes. Participation in the Plan will be terminated if the Plan Administrator receives written notice of the death or adjudicated incompetence of a Participant, together with satisfactory supporting documentation of the appointment of a legal representative, at least five business days before the next Record Date for purchases made through the reinvestment of dividends or Optional Cash Payments, as applicable. In the event written notice of death or adjudicated incompetence and such supporting documentation is received by the Plan Administrator less than five business days before the next Record Date for purchases made through the reinvestment of dividends or Optional Cash Payments, as applicable, shares will be purchased for the Participant with the related cash dividend or Optional Cash Payment and participation in the Plan will not terminate until after such dividend or payment has been reinvested. Thereafter, no additional purchase of shares will be made for the Participant's account and the Participant's shares and any cash dividends paid thereon will be forwarded to the Participant's legal representative.

Further, participation in the Plan may be terminated if all whole shares have been disbursed from your stockholder account and your Plan account, leaving only a fraction of a share.

Lastly, participation in the Plan may be terminated if we have reason to believe that your continued participation may cause your share ownership to violate our 9.8% charter limit on share ownership.

We reserve the right to modify, suspend or terminate participation in the Plan by otherwise eligible holders of shares of common stock or interested new investors to eliminate practices which are, in our sole discretion, not consistent with the purposes or operation of the Plan or which adversely affect the price of the shares of common stock.

Table of Contents

OTHER INFORMATION

29. What happens if you sell or transfer all of the shares registered in your name?

If you dispose of all shares registered in your name and all shares held in your Plan account, and are not shown as a Record Owner on a dividend Record Date, you may be terminated from the Plan as of that date and the termination treated as though a withdrawal notice had been received before the Record Date.

30. What happens if we declare a stock dividend or a stock split?

Any dividend payable in shares and any additional shares distributed by us in connection with a share split in respect of shares credited to your Plan account will be added to that account. Share dividends or split shares which are attributable to shares registered in your own name and not in your Plan account will be mailed directly to you as in the case of stockholders not participating in the Plan.

31. How will shares held by the Plan Administrator be voted at meetings of shareholders?

If you are a Record Owner, you will receive a proxy card covering both directly held shares and shares held in the Plan. If you are a Beneficial Owner, you will receive a proxy covering shares held in the Plan through your broker, bank, or other nominee. If a proxy is returned properly signed (unless returned electronically) and marked for voting, all the shares covered by the proxy will be voted as marked. If a proxy is returned properly signed (unless returned electronically) but no voting instructions are given, all of your shares will be voted in accordance with recommendations of our Board of Directors, unless applicable laws require otherwise. If the proxy is not returned, or if it is returned unexecuted or improperly executed (unless returned electronically) or improperly completed, shares registered in your name may be voted only by you in person; neither we nor the Plan Administrator will vote such shares.

32. What are our responsibilities and the Plan Administrator's responsibilities under the Plan?

We and the Plan Administrator will not be liable in administering the Plan for any act done in good faith or required by applicable law or for any good faith omission to act including, without limitation, any claim of liability arising out of failure to terminate a participant's account upon his or her death, with respect to the prices at which shares are purchased and/or the times when such purchases are made or with respect to any fluctuation in the market value before or after purchase or sale of shares. Notwithstanding the foregoing, nothing contained in the Plan limits our liability with respect to alleged violations of federal securities laws.

We and the Plan Administrator will be entitled to rely on completed forms and the proof of due authority to participate in the Plan, without further responsibility of investigation or inquiry.

33. May the Plan be changed or discontinued?

Yes. We may suspend, terminate, or amend the Plan at any time. Notice will be sent to you of any suspension or termination, or of any amendment that alters the Plan terms and conditions, as soon as practicable after such action by us.

We may appoint a successor administrator or agent in place of the Plan Administrator at any time. You will be promptly informed of any such appointment.

Any questions of interpretation arising under the Plan will be determined by us, in our sole discretion, and any such determination will be final.

Table of Contents

CERTAIN FEDERAL INCOME TAX CONSEQUENCES FOR PLAN PARTICIPANTS

34. What are the federal income tax consequences of participation in the Plan?

The following summarizes certain federal income tax considerations to current stockholders who participate in the Plan. New investors and current stockholders should also consult the general discussion under the caption "Federal Income Tax Considerations" for a summary of federal income tax considerations related to the ownership of our stock.

The following summary is based upon an interpretation of current federal tax law. It is important that you consult your own tax advisors to determine particular tax consequences, including state income tax (and non-income tax, such as stock transfer tax) consequences, which vary from state to state and which may result from participation in the Plan and the subsequent disposition of shares of common stock acquired pursuant to the Plan. Income tax consequences to participants residing outside the United States will vary from jurisdiction to jurisdiction.

Falk, Shaff & Ziebell, LLP, our tax and ERISA counsel, has rendered an opinion that the following are the material federal income tax consequences of participating in the Plan. However, the opinions of counsel are not binding on the Internal Revenue Service or on the courts, and no assurance can be given that the conclusions reached by Falk, Shaff & Ziebell, LLP, would be sustained in court.

Dividend Reinvestment Program

Participants in the Dividend Reinvestment program under the Plan will be treated for federal income tax purposes as having received, generally on the Investment Date, a distribution in an amount equal to the trading price on that date of the shares acquired with reinvested dividends. Such shares will have a tax basis equal to the same amount and the holding period for such shares will begin on the day following the Investment Date.

For federal income tax purposes, the fair market value of shares acquired under the Plan will likely be treated as equal to the closing price of shares on the related Investment Date. Such trading price on that specific date may vary from the Market Price determined under the Plan for such shares.

Example 1:

The following example may be helpful to illustrate the federal income tax consequences of the reinvestment of dividends at a 2% discount (the discount may range from 0% to 3%) from the Market Price where the trading price is the same as the Market Price.

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Cash dividends reinvested		\$	100.00
Assumed Market Price*	\$	30.00	
Less 2% discount per share	\$	(0.60)	
Net purchase price per share	\$	29.40	
Number of shares purchased (\$100.00/\$29.40)		3.4014	
Total taxable dividend resulting from transaction (30.00 x 3.4014)		\$	102.04

Stock Purchase Program

If you are a participant in the Dividend Reinvestment program under the Plan and you make optional cash purchases, you may be treated as having received a dividend distribution in an amount equal to the excess, if any, of the trading price of the shares acquired on the Investment Date over the amount you paid. We expect to report the excess as a dividend.

Shares acquired under the Stock Purchase program under the Plan will have a tax basis equal to the amount of the payment plus the dividend income, if any, recognized as a result. Your holding period for shares of common stock acquired pursuant to the Plan will begin on the day following the Investment Date.

Table of Contents**Example 2:**

The following example may be helpful to illustrate the federal income tax consequences of the Optional Cash Payment feature at a 2% discount (the discount may range from 0% to 3%) from the Market Price where the trading price on the purchase date differs from the Market Price as determined under the Plan's pricing formula.

Optional Cash Payment		\$ 100.00
Assumed Market Price*	\$ 30.00	
Less 2% discount per share	\$ (0.60)	
Net purchase price per share	\$ 29.40	
Trading price on stock purchase date	\$ 30.50	
Number of shares purchased (\$100.00/\$29.40)	3.4014	
Total taxable dividend resulting from transaction (3.4014 × \$30.50 - \$100.00)**		\$ 3.74

* The Market Price for determining the cost to a Plan participant of the shares under the Plan may differ from the trading price of the shares on the purchase or reinvestment date. The trading price on the purchase or reinvestment date is used for federal income tax purposes to determine the amount of the discount realized by a Plan participant.

** Assumes trading price on Investment Date equals \$30.50.

You will not realize any taxable income upon receipt of certificates for whole shares of common stock credited to your account, either upon your request for certain of those shares of common stock or upon your termination of participation in the Plan. You will recognize gain or loss upon the sale or exchange of shares of common stock acquired under the Plan. You will also recognize gain or loss upon receipt, following termination of participation in the Plan, of a cash payment for any fractional share equivalent credited to your account. The amount of any such gain or loss will be the difference between the amount that you received for the shares of common stock or fractional share equivalent and the tax basis thereof.

35. How are income tax withholding provisions applied to you?

If you fail to provide certain federal income tax certifications in the manner required by law, distributions on shares of common stock, proceeds from the sale of fractional shares and proceeds from the sale of shares of common stock held for your account will be subject to federal income tax backup withholding imposed at the fourth lowest tax rate applicable to unmarried individuals, or such other rate as is then in effect. If withholding is required for any reason, the appropriate amount of tax will be withheld before investment or payment. Certain stockholders (including most corporations) are, however, exempt from the above withholding requirements.

If you are a foreign stockholder you need to provide the required federal income certifications to establish your status as a foreign stockholder so that the foregoing backup withholding does not apply to you. You also need to provide the required certifications if you wish to claim the benefit of exemptions from federal income tax withholding or reduced withholding rates under a treaty or convention entered into between the United States and your country of residence. Generally, distributions to a foreign stockholder are subject to federal income tax withholding at 30% (or a lower treaty rate if applicable), but may be as much as 35% for certain types of income. Certain distributions or portion of a distribution to a foreign stockholder may still be subject to federal income tax withholding even when the distribution or that portion of the distribution is not treated as dividend under federal income tax laws. If you are a foreign stockholder whose distributions are subject to federal income tax withholding, the appropriate amount will be withheld and the balance will be credited to your account to purchase shares of common

stock.

Table of Contents

36. Who bears the risk of market fluctuations in our shares of common stock?

Your investment in shares held in the Plan account is no different from your investment in directly held shares. You bear the risk of any loss and enjoy the benefits of any gain from market price changes with respect to those shares.

37. Who should be contacted with questions about the Plan?

All correspondence regarding the Plan should be directed to the Plan Administrator. Please mention NovaStar Financial, Inc. and this Plan in all correspondence.

38. How is the Plan interpreted?

Any question of interpretation arising under the Plan will be determined by us and any such determination will be final. We may adopt additional terms and conditions of the Plan and its operation will be governed by the laws of the State of Missouri.

39. What are some of your responsibilities under the Plan?

Shares of common stock credited to your Plan account are subject to escheat to the state in which you reside in the event that such shares are deemed, under such state's laws, to have been abandoned by you. You, therefore, should notify the Plan Administrator promptly in writing of any change of address. Account statements and other communications to you will be addressed to you at the last address of record that you provide to the Plan Administrator.

You will have no right to draw checks or drafts against your Plan account or to instruct the Plan Administrator with respect to any shares of common stock or cash held by the Plan Administrator except as expressly provided in the Plan.

Table of Contents

FEDERAL INCOME TAX CONSIDERATIONS

The following discussion summarizes the material federal income tax consequences that may be relevant to a prospective purchaser of NovaStar's securities through the Plan. This discussion is based on current law. The following discussion is not exhaustive of all possible tax consequences. It does not give a detailed discussion of any state, local or foreign tax consequences, nor does it discuss all of the aspects of federal income taxation that may be relevant to a prospective investor in light of such investor's particular circumstances or to special classes of investors, including insurance companies, tax-exempt entities, financial institutions, broker/dealers, foreign corporations and persons who are not citizens or residents of the United States, subject to particular treatment under federal income tax laws.

Each prospective purchaser of the securities is urged to consult with his or her own tax advisor regarding the specific consequences to him or her of the purchase, ownership and sale of the securities, including the federal, state, local, foreign and other tax consequences of such purchase, ownership and sale and the potential changes in applicable tax laws.

General

The Code provides special tax treatment for organizations that qualify and elect to be taxed as REITs. The discussion below summarizes the material provisions applicable to NovaStar Financial as a REIT for federal income tax purposes and to its stockholders in connection with their ownership of shares of stock of NovaStar Financial. However, it is impractical to set forth in this prospectus all aspects of federal, state, local and foreign tax law that may have tax consequences with respect to an investor's purchase of the common stock. The discussion of various aspects of federal taxation contained herein is based on the Code, administrative regulations, judicial decisions, administrative rulings and practice, all of which are subject to change. In brief, if detailed conditions imposed by the Code are met, entities that invest primarily in real estate assets, including mortgage loans, and that otherwise would be taxed as corporations are, with limited exceptions, not taxed at the corporate level on their taxable income that is currently distributed to their stockholders. This treatment eliminates most of the double taxation, at the corporate level and then again at the stockholder level when the income is distributed, that typically results from the use of corporate investment vehicles. A qualifying REIT, however, may be subject to certain excise and other taxes, as well as normal corporate tax, on taxable income that is not currently distributed to its stockholders.

NovaStar Financial elected to be taxed as a REIT under the Code commencing with its taxable year ended December 31, 1996.

Opinion of Tax Counsel

Falk, Shaff & Ziebell, LLP, tax and ERISA counsel to NovaStar Financial, has advised NovaStar Financial in connection with the formation of NovaStar Financial, the private placement, our initial public offering, this offering and NovaStar Financial's election to be taxed as a REIT. Based on existing law and factual representations made to tax counsel by NovaStar Financial, tax counsel is of the opinion that NovaStar Financial, exclusive of any taxable affiliates, operated in a manner consistent with its qualifying as a REIT under the Code since the beginning of its taxable year ended December 31, 1996 through March 31, 2003, the date of the unaudited balance sheet and income statement made available to tax counsel, and the organization and contemplated method of operation of NovaStar Financial are such as to enable it to continue to so qualify throughout 2003 and in subsequent years. The opinion of tax counsel applies only to NovaStar Financial and its qualified REIT subsidiaries and not to NFI Holding and its subsidiaries, which operate as taxable entities. However, whether NovaStar Financial will in fact so qualify will depend on actual operating results and compliance with the various tests for qualification as a REIT relating to its income, assets, distributions, ownership and administrative matters, the results of which may not be reviewed by tax counsel. Moreover, some aspects of NovaStar Financial's operations have not been considered by the courts or the Internal Revenue

Table of Contents

Service. There can be no assurance that the courts or the Internal Revenue Service will agree with this opinion. In addition, qualification as a REIT depends on future transactions and events that cannot be known at this time. In the opinion of tax counsel, this section of the prospectus identifies and fairly summarizes the federal income tax consequences that are likely to be material to a holder of the common stock and to the extent such summaries involve matters of law, such statements of law are correct under the Code. Tax counsel's opinions are based on various assumptions and on the factual representations of NovaStar Financial concerning its business and assets.

This summary deals only with stock that is held as a capital asset, which generally means property that is held for investment. In addition, except to the extent discussed below, this summary does not address tax considerations applicable to you if you are subject to special tax rules, such as:

a dealer or trader in securities;

a financial institution;

an insurance company;

a shareholder that holds our stock as a hedge, part of a straddle, conversion transaction or other arrangement involving more than one position;

a shareholder whose functional currency is not the United States dollar; or

a tax-exempt organization or foreign taxpayer.

The opinions of tax counsel are also based upon existing law including the Code, existing Treasury Regulations, Revenue Rulings, Revenue Procedures, proposed regulations and case law, all of which is subject to change either prospectively or retroactively. Moreover, relevant laws or other legal authorities may change in a manner that could adversely affect NovaStar Financial or its stockholders. We urge you to consult your own tax advisors regarding the tax consequences of an investment in our stock, including the application to your particular situation of the tax considerations discussed below, as well as the application of state, local or foreign tax laws. The statements of federal income tax law set out below are based on the laws in force and their interpretation as of the date of this prospectus, and are subject to changes occurring after that date.

In the event NovaStar Financial does not qualify as a REIT in any year, it will be subject to federal income tax as a domestic corporation and its stockholders will be taxed in the same manner as stockholders of ordinary corporations. To the extent NovaStar Financial would, as a consequence, be subject to potentially significant tax liabilities, the amount of earnings and cash available for distribution to its stockholders would be reduced.

Qualification as a REIT

To qualify for tax treatment as a REIT under the Code, NovaStar Financial must meet certain tests which are described immediately below.

Ownership of Stock. For all taxable years after the first taxable year for which a REIT election is made, NovaStar Financial shares of stock must be transferable and must be held by a minimum of 100 persons for at least 335 days of a 12 month year or a proportionate part of a short tax year. Since the closing of its private placement, NovaStar Financial has had more than 100 shareholders of record. NovaStar Financial must, and does, use the calendar year as its taxable year. In addition, at all times during the second half of each taxable year, no more than 50% in value of the shares of any class of the stock of NovaStar Financial may be owned directly or indirectly by five or fewer individuals. In determining whether NovaStar Financial shares are held by five or fewer individuals, attribution of stock ownership rules apply. NovaStar Financial's charter imposes certain repurchase provisions and transfer restrictions to avoid more than 50% by value of any class of stock being held by five or fewer individuals, directly or constructively, at any time during the last half of any taxable year. Such repurchase and transfer restrictions will not cause the stock not to be treated as transferable for purposes of qualification as a REIT. NovaStar Financial has satisfied and intends to continue satisfying both the

Table of Contents

100 stockholder and 50%/5 stockholder individual ownership limitations described above for as long as it seeks qualification as a REIT. Treasury regulations require NovaStar Financial to demand from recordholders of designated percentages of our capital stock annual statements disclosing actual and beneficial ownership of stock.

Nature of Assets. On the last day of each calendar quarter at least 75% of the value of assets owned by NovaStar Financial must consist of qualified REIT assets, government securities, cash and cash items, the 75% of assets test. NovaStar Financial expects that substantially all of its assets, other than qualified hedges and the stock of NFI Holding, will be qualified REIT assets. Qualified REIT assets include interests in real property, interests in mortgage loans secured by real property and interests in REMICs. NovaStar Financial has complied with the 75% of assets test for each quarter since inception of its REIT election. Qualified hedges generally are financial instruments that a REIT enters into or acquires to protect against interest rate risks on debt incurred to acquire qualified REIT assets.

On the last day of each calendar quarter, of the investments in securities not included in the 75% of assets test, the value of any one issuer's securities may not exceed 5% by value of total assets, NovaStar Financial may not own more than 10% of any one issuer's outstanding voting securities and (other than securities of a taxable REIT subsidiary) it may not hold securities having a value of more than 10% of the value of the outstanding securities of the issuer. Pursuant to its compliance guidelines, NovaStar Financial intends to monitor closely, on not less than a quarterly basis, the purchase and holding of assets in order to comply with the above assets tests. In particular, as of the end of each calendar quarter NovaStar Financial intends to limit and diversify its ownership of securities of any taxable affiliate, hedging contracts and other mortgage securities that do not constitute qualified REIT assets to not more than 25%, in the aggregate, by value of its portfolio, to not more than 5% by value as to any single issuer, and to not more than 10% of the voting stock and 10% of the value of the outstanding stock of any single issuer, collectively the 25% of assets limits. In addition, as of the last day of any calendar quarter, not more than 20% of the value of the assets of NovaStar Financial may be represented by the securities of one or more taxable REIT subsidiaries, such as NFI Holding. If such limits are ever exceeded, NovaStar Financial intends to take appropriate remedial action to dispose of such excess assets within the 30 day period after the end of the calendar quarter, as permitted under the Code. As of December 31, 2002, NovaStar Financial complied with the tests described in this paragraph.

When purchasing mortgage-related securities, NovaStar Financial may rely on opinions of counsel for the issuer or sponsor of such securities given in connection with the offering of such securities, or statements made in related offering documents, for purposes of determining whether and to what extent those securities and the income therefrom constitute qualified REIT assets and income for purposes of the 75% of assets test and the source of income tests.

Sources of Income. NovaStar Financial must meet two separate income-based tests each year in order to qualify as a REIT.

1. The 75% Test. At least 75% of gross income, the 75% of income test for the taxable year must be derived from the following sources among others:

interest on, other than interest based in whole or in part on the income or profits of any person, and commitment fees to enter into, obligations secured by mortgages on real property;

gains from the sale or other disposition of interests in real property and real estate mortgages, other than gain from property held primarily for sale to customers in the ordinary course of business; and

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income from the operation, and gain from the sale, of property acquired at or in lieu of a foreclosure of the mortgage secured by such property or as a result of a default under a lease of such property.

Table of Contents

The investments that NovaStar Financial intends to make will give rise primarily to mortgage interest qualifying under the 75% of income test. As of December 31, 2002, NovaStar Financial complied with the 75% of income test on an annualized basis.

2. The 95% Test. In addition to deriving 75% of its gross income from the sources listed above, at least an additional 20% of gross income for the taxable year must be derived from those sources, or from dividends, interest or gains from the sale or disposition of stock or other securities that are not dealer property, the 95% of income test. Income attributable to assets other than qualified REIT assets, such as income from or gain on the disposition of qualified hedges, dividends on stock including any dividends from a taxable affiliate, interest on any other obligations not secured by real property, and gains from the sale or disposition of stock or other securities that are not qualified REIT assets will constitute qualified income for purposes of the 95% of income test only, and will not be qualified income for purposes of the 75% of income test. Income from mortgage servicing, loan guarantee fees or other contracts under which NovaStar Financial would earn fees for performing services and hedging other than from qualified REIT assets will not qualify for either the 95% or 75% of income tests. NovaStar Financial intends to severely limit its acquisition of any assets or investments the income from which does not qualify for purposes of the 95% of income test. Moreover, in order to help ensure compliance with the 95% of income test and the 75% of income test, NovaStar Financial intends to limit substantially all of the assets that it acquires, other than the stock of any taxable affiliate and qualified hedges, to qualified REIT assets. The policy of NovaStar Financial to maintain REIT status may limit the type of assets, including hedging contracts, that NovaStar Financial otherwise might acquire. As of December 31, 2002, NovaStar Financial complied with the 95% income test on an annualized basis.

For purposes of determining whether NovaStar Financial complies with the 75% of income test and the 95% of income test detailed above, gross income does not include gross income from prohibited transactions. A prohibited transaction is one involving a sale of property in which the seller is a dealer. A prohibited transaction does not include a sale of dealer property by a REIT for which the foreclosure property election is made. Net income from prohibited transactions is subject to a 100% tax.

NovaStar Financial intends to maintain its REIT status by carefully monitoring its income, including income from hedging transactions, futures contracts and sales of Mortgage Assets to comply with the 75% of income test and the 95% of income test. In order to help insure its compliance with the REIT requirements of the Code, NovaStar Financial has adopted guidelines the effect of which will be to limit its ability to earn certain types of income, including income from hedging, other than hedging income from qualified REIT assets and from qualified hedges.

Failure to satisfy one or both of the 75% or 95% of income tests for any year may result in either (a) a 100% tax on the greater of the amounts of income by which it failed to comply with the 75% test of income or the 95% of income test, reduced by estimated related expenses, assuming such failure was for reasonable cause and not willful neglect, or (b) loss of REIT status. There can be no assurance that NovaStar Financial will always be able to maintain compliance with the gross income tests for REIT qualification despite periodic monitoring procedures. Moreover, there is no assurance that the relief provisions for a failure to satisfy either the 95% or the 75% of income tests will be available in any particular circumstance.

Distributions. NovaStar Financial must distribute to its stockholders on a pro rata basis each year an amount equal to

90% of its taxable income before deduction of dividends paid and excluding net capital gain, plus

90% of the excess of the net income from foreclosure property over the tax imposed on such income by the Code, less

any excess noncash income.

Table of Contents

NovaStar Financial intends to make distributions to its stockholders in amounts sufficient to meet this 90% distribution requirement. Such distributions must be made in the taxable year to which they relate or, if declared before the timely filing of the tax return for such year and paid not later than the first regular dividend payment after such declaration, in the following taxable year.

If NovaStar Financial fails to meet the 90% distribution test as a result of an adjustment to tax returns by the Internal Revenue Service, NovaStar Financial by following certain requirements set forth in the Code may pay a deficiency dividend within a specified period which will be permitted as a deduction in the taxable year to which the adjustment is made. NovaStar Financial would be liable for interest based on the amount of the deficiency dividend. A deficiency dividend is not permitted if the deficiency is due to fraud with intent to evade tax or to a willful failure to file a timely tax return. NovaStar Financial generally distributes dividends equal to 100% of its taxable income to eliminate corporate level tax.

Taxation of NovaStar Financial

In any year in which NovaStar Financial qualifies as a REIT, it generally will not be subject to federal income tax on that portion of its taxable income or net capital gain which is distributed to its stockholders. NovaStar Financial will, however, be subject to tax at normal corporate rates upon any net income or net capital gain not distributed. NovaStar Financial intends to distribute substantially all of its taxable income to its stockholders on a pro rata basis in each year.

In addition, NovaStar Financial will also be subject to a tax of 100% of net income from any prohibited transaction and will be subject to a 100% tax on the greater of the amount by which it fails either the 75% or 95% of income tests, reduced by approximated expenses, if the failure to satisfy such tests is due to reasonable cause and not willful neglect and if certain other requirements are met. NovaStar Financial may be subject to the alternative minimum tax on certain items of tax preference.

If NovaStar Financial acquires any real property as a result of foreclosure, or by a deed in lieu of foreclosure, it may elect to treat such real property as foreclosure property. Net income from the sale of foreclosure property is taxable at the maximum federal corporate rate, currently 35%. Income from foreclosure property will not be subject to the 100% tax on prohibited transactions. NovaStar Financial will determine whether to treat such real property as foreclosure property on the tax return for the fiscal year in which such property is acquired. NovaStar Financial expects to so elect.

NovaStar Financial securitizes mortgage loans and sells the resulting mortgage securities through one or more taxable subsidiaries. However, if NovaStar Financial itself were to sell such mortgage assets on a regular basis, there is a substantial risk that it would be deemed dealer property and that all of the profits from such sales would be subject to tax at the rate of 100% as income from prohibited transactions. The taxable subsidiary will not be subject to this 100% tax on income from prohibited transactions, which is only applicable to REITs.

In addition, NovaStar Financial will be subject to a 100% penalty tax equal to any rent or other charges that it imposed on any taxable subsidiary in excess of an arm's-length price for comparable services. NovaStar Financial will derive income from its taxable subsidiaries by way of dividends. Such dividends are non-real estate source income for purposes of the 75% of income test. Therefore, when aggregated with NovaStar Financial's other non-real estate source income, such dividends must be limited to 25% of NovaStar Financial's gross income each year. NovaStar Financial will monitor the value of its investment in its taxable subsidiaries and the amount of dividends received from such subsidiaries to ensure compliance with all applicable income and asset tests.

NovaStar Financial's taxable subsidiaries are generally subject to corporate level tax on their net income and will generally be able to distribute only net after-tax earnings to its stockholders, including NovaStar Financial, as dividend distributions.

Table of Contents

A nondeductible excise tax, equal to 4% of the excess of the required distributions (as shown in the following bulleted list) over the amounts actually distributed will be imposed for each calendar year to the extent that dividends paid during the year, or declared during the last quarter of the year and paid during January of the succeeding year, are less than the sum of:

85% of NovaStar Financial's ordinary income,

95% of NovaStar Financial's capital gain net income, and

income not distributed in earlier years.

NovaStar Financial generally will declare its fourth regular annual dividend during the final quarter of the year and make such dividend distribution no later than thirty-one (31) days after the end of the year in order to avoid imposition of the excise tax. Such a distribution would be taxed to the stockholders in the year that the distribution was declared, not in the year paid. Imposition of the excise tax on NovaStar Financial would reduce the amount of cash available for distribution to stockholders.

Termination or Revocation of REIT Status

The election to be treated as a REIT will be terminated automatically if NovaStar Financial fails to meet the requirements described above. In that event, NovaStar Financial will not be eligible again to elect REIT status until the fifth taxable year which begins after the year for which the election was terminated unless all of the following relief provisions apply:

NovaStar Financial did not willfully fail to file a timely return with respect to the termination taxable year;

inclusion of incorrect information in such return was not due to fraud with intent to evade tax; and

NovaStar Financial establishes that failure to meet requirements was due to reasonable cause and not willful neglect.

NovaStar Financial may also voluntarily revoke its election, although it has no intention of doing so, in which event NovaStar Financial will be prohibited, without exception, from electing REIT status for the year to which the revocation relates and the following four taxable years.

If NovaStar Financial were to fail to qualify for taxation as a REIT in any taxable year, and if the relief provisions were not to apply, NovaStar Financial would be subject to tax, including any applicable alternative minimum tax, on its taxable income at regular corporate rates. Distributions to stockholders with respect to any year in which NovaStar Financial were to fail to qualify as a REIT would not be deductible by NovaStar Financial nor would any dividends be required to be made. Failure to qualify as a REIT would result in a reduction of its distributions to stockholders in order to pay the resulting corporate level taxes. If, after forfeiting REIT status, NovaStar Financial later qualifies and elects to be taxed as a REIT again, NovaStar Financial could face significant adverse tax consequences.

Taxation of the Company's Stockholders

General. For any taxable year in which NovaStar Financial is treated as a REIT for federal income purposes, amounts distributed by NovaStar Financial to its stockholders out of current or accumulated earnings and profits will be includible by the stockholders as ordinary income for federal income tax purposes unless properly designated by NovaStar Financial as capital gain dividends. In the latter case, the distributions will be taxable to the stockholders as long-term capital gains.

Distributions will not be eligible for the dividends received deduction available for non-REIT corporations. Stockholders may not deduct any net operating losses or capital losses of NovaStar Financial. Any loss on the

Table of Contents

sale or exchange of shares of the stock held by a stockholder for six months or less will be treated as a long-term capital loss to the extent of any capital gain dividend received on the stock held by such stockholders.

If NovaStar Financial makes distributions to its stockholders in excess of its current and accumulated earnings and profits, those distributions will be considered first a tax-free return of capital, reducing the tax basis of a stockholder's shares until the tax basis is zero. Any such distributions in excess of the tax basis will be taxable as gain realized from the sale of shares.

NovaStar Financial, exclusive of its taxable affiliates, does not expect to acquire or retain residual interests issued by REMICs. Such residual interests, if acquired by a REIT, would generate excess inclusion income to shareholders of the REIT. Excess inclusion income cannot be offset by net operating losses of a stockholder. If the stockholder is a tax-exempt entity, the excess inclusion income is fully taxable as unrelated trade or business income as defined in Section 512 of the Code. If allocated to a foreign stockholder, the excess inclusion income is subject to Federal income tax withholding without reduction pursuant to any otherwise applicable tax treaty. Excess inclusion income realized by a taxable affiliate is not passed through to stockholders. Potential investors, and in particular tax exempt entities, are urged to consult with their tax advisors concerning this issue.

NovaStar Financial will notify stockholders after the close of the taxable year as to the portions of the distributions which constitute ordinary income, return of capital and capital gain. Dividends and distributions declared in the last quarter of any year payable to stockholders of record on a specified date in such month will be deemed to have been received by the stockholders and paid on December 31 of the record year, provided that such dividends are paid before February 1 of the following year.

Taxation of Tax-Exempt Entities

In general, a tax-exempt entity that is a stockholder of NovaStar Financial is not subject to tax on distributions. The Internal Revenue Service has ruled that amounts distributed by a REIT to an exempt employee's pension trust do not constitute unrelated trade or business income and thus should be nontaxable to such a tax-exempt entity. Tax counsel is of the opinion that indebtedness incurred by NovaStar Financial in connection with the acquisition of real estate assets such as mortgage loans will not cause dividends paid to a stockholder that is a tax-exempt entity to be unrelated trade or business income, provided that the tax-exempt entity has not financed the acquisition of its stock with acquisition indebtedness within the meaning of the Code. Under some conditions, if a tax-exempt employee pension or profit sharing trust were to acquire more than 10% of the stock of NovaStar Financial, a portion of the dividends on such stock could be treated as unrelated trade or business income.

For social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts, and qualified group legal services plans exempt from federal income taxation under Code Sections 501(c)(7), (c)(9), (c)(17) and (c)(20), respectively, income from an investment in NovaStar Financial will constitute unrelated trade or business income unless the organization is able to properly deduct amounts set aside or placed in reserve for certain purposes so as to offset the unrelated trade or business income generated by its investment. Such entities should review Code Section 512(a)(3) and should consult their own tax advisors concerning these set aside and reserve requirements.

Foreign Investors

The preceding discussion does not address the federal income tax consequences to foreign investors, nonresident aliens and foreign corporations as defined in the Code, of an investment in NovaStar Financial. In general, foreign investors will be subject to special withholding tax

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requirements on income and capital gains distributions attributable to their ownership of NovaStar Financial stock. Foreign investors should consult their own tax advisors concerning the federal income tax consequences to them of a purchase of shares of NovaStar Financial stock including the federal income tax treatment of dispositions of interests in, and the receipt of

Table of Contents

distributions from, REITs by foreign investors. In addition, federal income taxes must be withheld on certain distributions by a REIT to foreign investors at a flat rate of 30% unless reduced or eliminated by an income tax treaty between the United States and the foreign investor's country or unless the Shares are held in connection with the foreign investor's U.S. business. A foreign investor eligible for reduction or elimination of withholding must file an appropriate form with NovaStar Financial (or the appropriate withholding agent) in order to claim such treatment.

Backup Withholding

The Code imposes a modified form of backup withholding for payments of interest and dividends. This withholding applies only if a stockholder, among other things,

fails to furnish NovaStar Financial with a properly certified taxpayer identification number;

fails properly to report interest or dividends from any source; or

under certain circumstances fails to provide NovaStar Financial or the stockholder's securities broker with a certified statement, under penalty of perjury, that he or she is not subject to backup withholding.

The backup withholding rate is 30% for 2003 and 29% for 2004 of reportable payments, which include dividends. Stockholders should consult their tax advisors as to the procedure for ensuring that distributions to them will not be subject to backup withholding.

NovaStar Financial will report to its stockholders and the Internal Revenue Service the amount of dividends paid during each calendar year and the amount of tax withheld, if any.

Pending Tax Legislation

The Bush Administration's 2004 Budget contains a proposal to exempt from income taxation to the recipient of some or all of the dividends paid by tax-paying corporations. The proposal by its terms does not apply to REITs and certain other tax-favored types of corporations. If the proposal is enacted as proposed, individual investors would have to pay income tax on dividends that we pay, but would have to pay less or no income tax on the dividends paid by tax-paying corporations. It is possible that enactment of that proposal in its current form could have a negative effect on the market value of our stock.

State and Local Taxes

State and local tax laws may not correspond to the federal income tax principles discussed in this section. Accordingly, prospective stockholders should consult their tax advisers concerning the state and local tax consequences of an investment in NovaStar Financial's stock.

DIVIDENDS

We generally intend to distribute substantially all of our taxable income each year (which does not ordinarily equal net income as calculated in accordance with generally accepted accounting principles) to our stockholders so as to comply with the REIT provisions of the Internal Revenue Code. We intend to make dividend distributions quarterly and to distribute any taxable income remaining after the distribution of the final regular quarterly dividend each year together with the first regular quarterly dividend payment of the following taxable year or in a special dividend distributed prior thereto. Our dividend policy is subject to revision at the discretion of our Board of Directors. All distributions will be made at the discretion of our Board of Directors and will depend on our taxable income, our financial condition, maintenance of REIT status and other factors as our Board of Directors deems relevant.

Table of Contents

Distributions to stockholders will generally be subject to tax as ordinary income, although a portion of the distributions may be designated by us as capital gain or may constitute a tax-free return of capital. We generally do not intend to declare dividends that would result in a return of capital. Annually, our transfer agent will furnish to each of our stockholders a statement of distributions paid during the preceding year and their characterization as ordinary income, capital gains or return of capital.

USE OF PROCEEDS

We do not know either the number of shares of common stock that will be ultimately sold pursuant to the Plan or the prices at which such shares will be sold. We will receive proceeds from the purchase of shares of common stock through the Plan only to the extent that such purchases are made directly from us and not from open market purchases by the Plan Administrator. We will bear the costs relating to the registration of the common stock being offered, estimated to be \$70,000. We intend to use the net proceeds from the sale of such shares of our common stock for the purchase of additional mortgage assets and for other general corporate purposes.

PLAN OF DISTRIBUTION

Except to the extent the Plan Administrator purchases common stock in open market transactions, the common stock acquired under the Plan will be sold directly by us through the Plan. We may sell common stock to owners of shares (including brokers or dealers) who, in connection with any resales of such shares, may be deemed to be underwriters. Such shares, including shares acquired pursuant to waivers granted with respect to the Stock Purchase program of the Plan, may be resold in market transactions (including coverage of short positions) on any national security exchange on which shares of common stock trade or in privately negotiated transactions. Our common stock is currently listed on the NYSE.

Under certain circumstances, it is expected that a portion of the shares of common stock available for issuance under the Plan will be issued pursuant to such waivers. The difference between the price such owners pay to us for shares of common stock acquired under the Plan, after deduction of the applicable discount from the Market Price, and the price at which such shares are resold, may be deemed to constitute underwriting commissions received by such owners in connection with such transactions.

Subject to the availability of shares of common stock registered for issuance under the Plan, there is no total maximum number of shares that can be issued pursuant to the reinvestment of dividends. From time to time, financial intermediaries may engage in positioning transactions to benefit from the discount from the Market Price of common stock acquired through the reinvestment of dividends under the Plan.

We will pay any and all brokerage commissions and related expenses incurred in connection with purchases of common stock under the Plan. Upon withdrawal by a participant from the Plan by the sale of common stock held under the Plan, the participant will receive the proceeds of such sale less a nominal fee per transaction paid to the Plan Administrator (if such resale is made by the Plan Administrator at the request of a participant), any related brokerage commissions and any applicable transfer taxes.

Common stock may not be available under the Plan in all jurisdictions. This prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, any common stock or other securities in any jurisdiction to any person to whom it is unlawful to make such offer in such

jurisdiction.

Table of Contents

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. Our SEC filings are available to the public over the Internet at the SEC's web site at <http://www.sec.gov>. You may also read and copy any document we file at the SEC's public reference facilities maintained by the Commission in Washington, D.C., New York, New York, and Chicago, Illinois.

Public Reference Room
450 Fifth Street, N.W.
Washington, DC 20549

New York Regional Office
233 Broadway
New York, NY 10279

Chicago Regional Office
500 West Madison Street
Suite 1400
Chicago, IL 60661

Please call the SEC at 1-800-SEC-0300 for further information on the public reference rooms.

We have filed a registration statement, of which this prospectus is a part, covering the securities offered hereby. As allowed by SEC rules, this prospectus does not contain all the information set forth in the registration statement and the exhibits, financial statements and schedules thereto. We refer you to the registration statement, the exhibits, financial statements and schedules thereto for further information. This prospectus is qualified in its entirety by such other information. You may request a free copy of any of the above filings by writing or calling:

Corporate Secretary

NovaStar Financial, Inc.

8140 Ward Parkway, Suite 300

Kansas City, MO 64114

(816) 237-7000

You should rely only on the information provided in this prospectus. We have not authorized anyone else to provide you with different information. You should not assume that the information in this prospectus is accurate as of any date other than the date on the cover page of this prospectus.

Table of Contents

INCORPORATION OF IMPORTANT INFORMATION BY REFERENCE

The Commission allows us to incorporate by reference information into this prospectus, which means that we can disclose important information to you by referring you to another document filed separately with the Commission. The information incorporated by reference is deemed to be part of this prospectus, except for any information superseded by information in this prospectus.

We have filed the documents listed below with the Commission under the Securities Exchange Act of 1934, the Exchange Act, and these documents are incorporated herein by reference:

Our Annual Report on Form 10-K for the year ended December 31, 2002, as amended (including the portions of our Proxy Statement on Schedule 14A incorporated therein by reference);

Our Quarterly Report on Form 10-Q for the quarter ended March 31, 2003; and

The description of our common stock included in our registration statements on Form 8-A, as amended, under the Exchange Act.

Any documents we file pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and prior to the termination of the offering of the securities to which this prospectus relates will automatically be deemed to be incorporated by reference in this prospectus and to be part hereof from the date of filing those documents. Any documents we file pursuant to these sections of the Exchange Act after the date of the initial registration statement that contains this prospectus and prior to the effectiveness of the registration statement will automatically be deemed to be incorporated by reference in this prospectus and to be part hereof from the date of filing those documents.

Any statement contained in this prospectus or in a document incorporated by reference shall be deemed to be modified or superseded for all purposes to the extent that a statement contained in this prospectus or in any other document which is also incorporated by reference modifies or supersedes that statement. You may obtain copies of all documents which are incorporated in this prospectus by reference (other than the exhibits to such documents unless the exhibits are specifically incorporated herein by reference in the documents that this prospectus incorporates by reference) without charge upon written or oral request to NovaStar Financial, Inc., 8140 Ward Parkway, Suite 300, Kansas City, Missouri 64114, telephone (816) 237-7000.

LEGAL MATTERS

The validity of the common stock offered and certain legal matters will be passed upon by Tobin & Tobin, a professional corporation, San Francisco, California. Certain tax matters will be passed on by Falk, Shaff & Ziebell, LLP, Irvine, California.

EXPERTS

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The consolidated financial statements for the years ended December 31, 2002 and 2001 incorporated in this prospectus by reference from our Annual Report on Form 10-K for the year ended December 31, 2002, as amended, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report, which is incorporated herein by reference, and have been so incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The consolidated income statement for the year ended December 31, 2000 incorporated in this prospectus by reference from our Annual Report on Form 10-K for the year ended December 31, 2002, as amended, has been audited by KPMG LLP, independent auditors, as stated in their report, which is incorporated herein by reference, and has been so incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

Table of Contents

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information.

We are not offering the securities in any state where the offer is not permitted.

We do not claim that the information in this prospectus is accurate as of any date other than the date stated on the cover.

300,000 Shares

NovaStar Financial, Inc.

Common Stock

[Logo]

PROSPECTUS

May 28, 2003
