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Bondholder Beware: The New Era of LNG Project Financing

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Remember the good old days when watching your favorite NFL team didn't require ten different streaming services? Or when you booked a hotel room and didn't get stuck with a daily $50 resort fee? Unfortunately, we believe we will look back at the 2015-2020 period as the good old days for fixed income investors of LNG projects. To the extent new projects have tolling agreements in place for capacity, the terms are shorter and the counterparties are weaker. Buyer beware!

Liquefied Natural Gas Export Facilities Investments

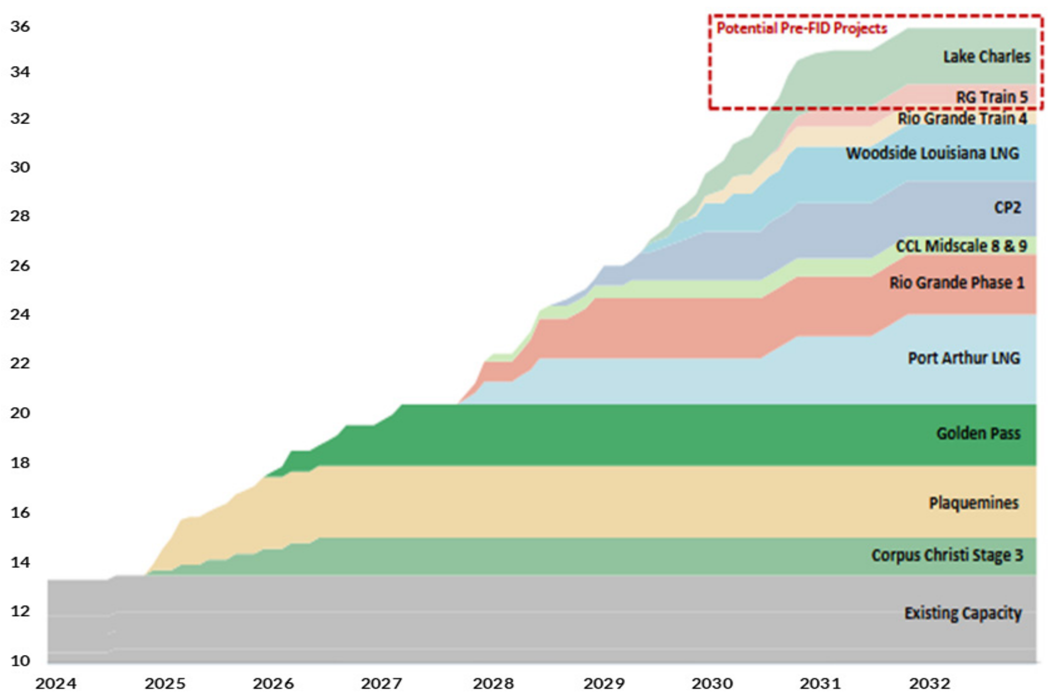
Today, liquefied natural gas (LNG) export facilities have allowed the U.S. to export about 15 billion cubic feet of natural gas per day. The issuers of these bonds have had stable credit profiles reflecting the strength of the predictable, contracted cash flows provided by long-term tolling agreements with highly rated counterparties.

The tolling agreements generally have a duration exceeding the maturity of the bonds we have invested in and include a fixed reservation fee sized to cover 100% of the debt service. What makes these contracts appealing from a fixed income perspective is that the issuer takes no commodity or volume risk on contracted capacity and operational costs are reimbursed by the tolling customers on a pass-through basis. The fixed reservation fee is paid whether the tolling counterparties actually utilize the capacity or not. Moreover, the tolling customers are responsible for the procurement, transportation and delivery of natural gas, and of transporting and selling the LNG. The limited volatility of the cash flows allowed sponsors to use debt for a large portion of the single asset capital structure.

Exports to Double In Next Five Years

U.S. exports of natural gas are expected to double from 15 billion cubic feet per day to more than 30 billion cubic feet per day within the next 5 years (Figure 1). To put that in context, AI/data center-related natural gas demand is expected to increase by “only” about 5 billion cubic feet per day in that same time period. These export expectations will require another buildout of LNG facilities – five such facilities have been announced year to date, which will require about $55 billion of capital[1]. We suspect fixed-income investors will again have many opportunities to either fund the buildout, refinance construction loans or fund a sponsor distribution. However, the tolling agreements for the new LNG facilities being built appear to be less bondholder friendly than in the past.

Figure 1: LNG Export Capacity (Bcf/d)



Source: Morgan Stanley; Time to Turn Up the Gas; September 26, 2025

Recent LNG Buildout Announcements Are Weaker than in the Past

Historically, U.S. LNG export projects typically have commitments for two-thirds or more of their output usually for 20 years with very strong counterparties before making the decision to move forward with construction. However, two of the most recent LNG export facility announcements, from Woodside Energy and Sempra Infrastructure Partners, have been marked departures from historical precedent. Woodside is moving forward on the $17.5 billion Louisiana LNG terminal despite only 6% of future capacity under contract for 13 years[2]. Sempra Infrastructure Partners is also moving forward with the $14 billion Port Arthur 2 facility despite only 57% of future capacity under contract for 20

1 55 million tons per annum at an approximate cost of $1,000 per ton (Jefferies, October 3, 2025)
2 Woodside Energy; Woodside Approves Louisiana LNG Development; April 29, 2025

years[3]. If no additional capacity contracts are signed before 2030 when operations are expected to begin, investors in these projects will be taking on both commodity and volume risk. Future fixed income investors should require the capital structure for these investments are levered appropriately and or demand appropriate compensation for taking on commodity, volume and financial risk.

Why the Change In Deciding When to Construct?

We believe that the sponsors are choosing to move forward without full capacity commitments for two reasons. First, sponsors want to take advantage of engineering and procurement agreements in place rather than renegotiate them with so many projects competing for contractors. According to Jeffries, US LNG project capex has already risen from approximately $750 per ton in 2014-2019 to close to $1,000 per ton currently. Delaying plans further until 100% of export capacity is contracted would open up engineering agreements, likely leading to even higher capital costs. Secondly, conventional buyers of LNG (highly rated European and Asian utilities) are increasingly reluctant to commit to long term capacity tolling agreements due to the large amounts of renewable electricity now available in their portfolio. As a result, U.S. gas producers which are typically weaker counterparties than foreign utilities are stepping in and committing to a portion of the capacity (Port Arthur 2 is an excellent example).

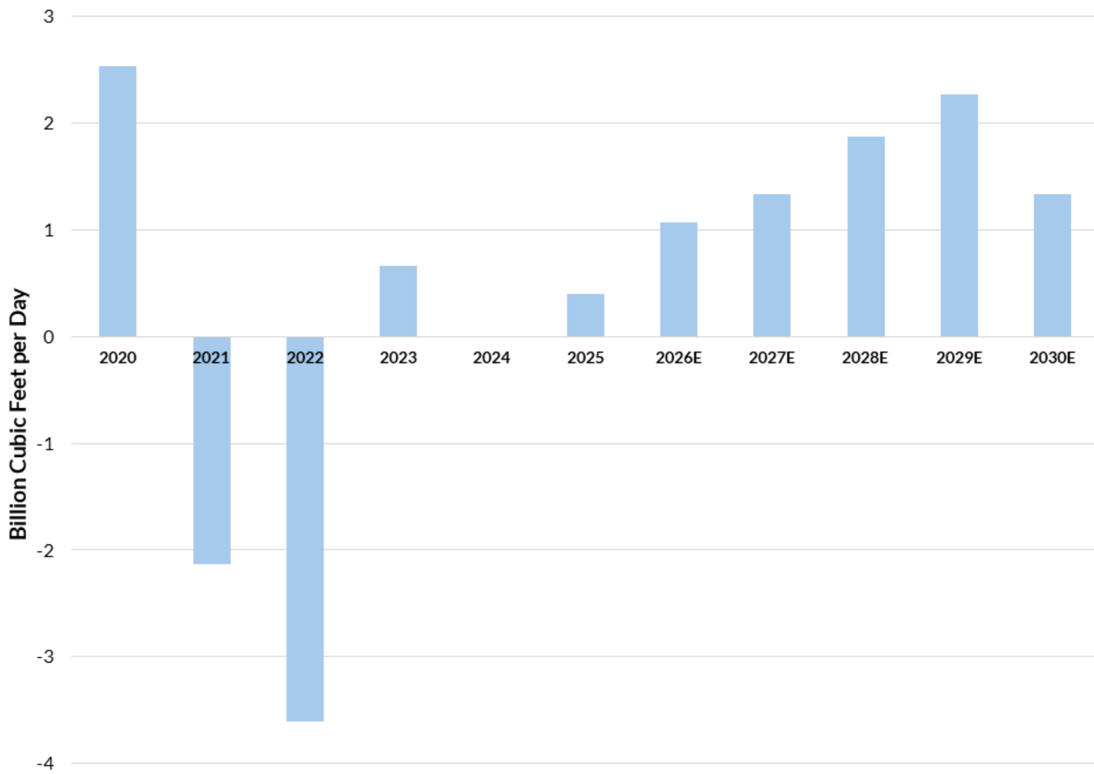
LNG Export Environment Is Currently Hot, But Will It Remain So in 2030?

Having uncontracted export capacity is great when demand for LNG far exceeds supply – like the environment since the Russian/Ukraine conflict began and Europe attempted to replace 14 billion cubic feet per day of natural gas from Russia. Will that unbalanced situation, which has been so favorable to U.S. LNG exporters with available uncontracted capacity, remain in place in 2030?

We are skeptical for several reasons. On the supply side, in addition to the U.S. LNG buildout, Qatar, Canada and others are expanding export capacity by 36% over the next five years. On the demand side, we are concerned that Chinese LNG demand may erode following an agreement between the Chinese and Russia to increase flows on the Power of Siberia 1 pipeline and potentially the Power of Siberia 2. This could curtail demand by at least 3% per year beginning in 2027. Additionally, legislation is in place which aims to reduce the EU's net greenhouse gas (GHG) emissions by at least 55% from their 1990 levels by 2030 and put the EU on course to become carbon neutral by 2050. The legislation was adopted by the European parliament in October 2023 and its emissions targets are legally binding on all EU member states. We believe that these factors could contribute to a much weaker fundamental situation than now (Figure 2).

3 Sempra Energy; Sempra Announces Strategic Transactions Advancing Goal of Building Leading U.S. Utility Growth Business; September 23, 2025

Figure 2: LNG Surplus/(Shortage)



Source: Morgan Stanley; More Supply on the Horizon; 9/19/2025

Fixed income investors need to scrutinize upcoming issues to fund new U.S. LNG export facilities due to a change in both the tolling agreements for the specific facilities and softer natural gas fundamentals at the end of this decade. Assuming there are limited additional long-term contracts signed with those facilities, investors will be subject to both commodity risk and volume risk for the uncontracted capacity when operations begin in 2029-2031, a period of time when natural gas fundamentals appear to be soft. Moreover, the contracted capacity will be with weaker counterparties than some of the conventional LNG related bond issues of the past ten years.

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