

Catching the wave: What role will US LNG play?

By Jason Bordoff and Akos Losz

Founding Director and Senior Research Associate respectively,
SIPA Centre on Global Energy Policy, Columbia University



The rapid emergence of the United States – alongside Australia – as one of the world's largest exporters of liquefied natural gas (LNG) between 2015 and 2020 was widely expected to create a decade-long glut in the global LNG market. However, to the surprise of most analysts, global LNG demand has proved more than a match for fast-growing LNG supplies, initially led by a collection of new and emerging LNG importers, and later by the policy-driven demand boom in China. Over the past 12 months or so, talk of a looming LNG market oversupply has given way to tightening markets and fears of a supply shortage by the early 2020s, or potentially even sooner. Given the LNG demand outlook and the three to five-year lead time of new liquefaction projects, new LNG investments are required in the near-term to avoid demand outstripping supply in the years ahead, resulting in tighter markets and higher prices.

Despite a robust demand outlook, investment in new LNG supply capacity has come to a standstill in the last couple of years, as buyers have been less willing to sign long-term offtake agreements, and suppliers have thus struggled to secure project finance debt, which is still needed for the majority of new LNG projects. How this impasse will get resolved – and what role the United States will play in the next wave of LNG supply – is a key question for the future global energy system.

Breaking the Impasse

In the last couple of years, the global LNG industry has found itself in a bit of a catch-22 situation, with buyers unwilling to sign long-term deals linked to the price of oil, banks reluctant to lend, and suppliers challenged to sanction new projects. Because of the impasse, final investment decisions have been few and far between since 2016. Until a few months ago, industry analysts had wondered who will blink first: the buyers, the suppliers or the financiers.

Since the global LNG market started to tighten in late 2017, however, buyer appetite for long-term LNG contracts appears to be returning strongly. Meanwhile, LNG suppliers are looking for ways around the traditional project-finance-based model, including through balance-sheet financing, more portfolio offtake, and innovative new business models. Where differences between buyer expectations and seller requirements still remain, portfolio players and trading houses can increasingly step in to aggregate and intermediate. Some traditional buyers (e.g., in Japan) are also looking to play a more active role as traders and portfolio aggregators in the

marketplace. As we approach the end of 2018, the market seems to be moving past the deadlock, and the race to build the next wave of LNG projects is now well underway. The launch of Cheniere Energy's Corpus Christi Train 3 project in the US Gulf Coast earlier this year seems to have kicked off a new investment cycle.

What Role for Second-Wave US LNG Projects?

As the global LNG industry gears up for another round of investment in new capacity, US-based projects could once again play a major role in the upcoming investment cycle, just as they did during the previous one. New American liquefaction projects have some important advantages over many of their overseas competitors, including their relatively low construction cost, limited completion risk, destination flexibility, and transparent Henry Hub-based pricing. These characteristics make American projects attractive in the eyes of many prospective buyers around the world, including in China.

At the same time, there are also a number of challenges that exist for US-based LNG projects.

Permitting delays at the Federal Energy Regulatory Commission (FERC) could be one such roadblock. Staffing shortages and a steady stream of applications created a growing backlog at the FERC earlier this year, and slowed down the permitting of new LNG projects considerably. The agency has since taken steps to speed up permitting, including hiring outside contractors and outsourcing some aspects of the review process to the PHMSA. The recent changes should still enable most second-wave projects to take a final investment decision by the end of 2019. But any further slippage in the permitting process could mean that some developers miss the window, and thus have to wait until the next turn of the cycle before they can once again consider launching their project.

The competitiveness of US LNG—particularly in Asia—can be another challenge. Although the cost of building liquefaction capacity is comparably low for second-wave US projects, the cost of feed gas in America, which is linked to the Henry Hub index in most cases, is higher than for competing projects in Qatar, Mozambique, Russia and elsewhere. Projects along the US Gulf Coast are also further away from key LNG markets in Asia than most competitors, which means higher transportation costs for US exporters. The landed cost of US gas in Asia could further increase, if the Panama Canal becomes a bottleneck for LNG transit, although the waterway has so far been able to accommodate the growing LNG flows between the US Gulf Coast and the Pacific Basin. While some



The US is set to become a major LNG exporter

US projects might find ways to source gas at a price below Henry Hub (and thus improve their cost structure), the full cost of delivering US LNG to Asia remains mostly in the range of US\$8 per MMBtu, which positions American developers higher up on the cost curve than some of the lowest-cost opportunities in other geographies.

Trade wars are another nuisance for American LNG exporters. The 25 percent tariff on imported steel, which the Trump administration implemented earlier this year, imposes direct costs on new US LNG and pipeline projects. While the steel tariff, in and of itself, will hardly be a fatal blow to the US LNG industry, it can nevertheless increase project costs by a few percent, and impose an unnecessary burden that can weaken the economics of new US LNG projects vis-à-vis their global competitors.

America's escalating trade war with China also comes at an unfortunate time for second-wave US projects. The market window for the next wave of LNG supply has recently opened, and the global competition to finalise commercial arrangements and reach final investment decisions within the next one or two years remains fierce. US LNG projects are well-positioned in this competition. But the potential loss of long-term buyers in China—the largest source of LNG demand growth in the foreseeable future—can be a disadvantage for US projects, particularly for those that are developed by

independent players and need to raise project finance debt on the back of long-term offtake agreements. The potential for an escalating trade war with the fastest-growing LNG import market may deter investment in the US relative to other sources of new LNG export capacity. Moreover, many US projects are actively marketing to Chinese buyers or even have reached preliminary agreements in some cases. The ongoing trade dispute may give pause to potential Chinese buyers in their discussions with US project developers. If the trade tensions persist for a prolonged period, then interested Chinese buyers may be compelled to look elsewhere for long-term LNG volumes—and potentially help overseas projects cross the finish line ahead of their US rivals. Given the need for new financing models for the next wave of US LNG export projects, there is the possibility for Chinese investment in the projects themselves, yet that may raise political as well as regulatory challenges in Washington DC given the need for Committee on Foreign Investment in the United States (CFIUS) review and approval.

America has every opportunity to play a prominent part in the next wave of global LNG expansion. But, as the above list of potential headwinds indicates, despite the Trump administration's "energy dominance" rhetoric and efforts to boost production by rolling back regulations, US policy is currently creating its own set of challenges as well. ●