Freeport LNG train three, Texas

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Export liquefied natural gas (LNG) projects in the US have gradually added new complexities to the financing structures. Freeport LNG's third train, which closed its financing for train three on 28 April 2015, introduced mezzanine debt to the asset class.

The $4.56 billion financing for train three comprises $3.64 billion in senior debt and $925 million in mezzanine debt. Freeport LNG Development has retained 100% equity in the train, but has sourced that equity entirely from mezzanine debt.

For the first two trains, Freeport LNG sold equity to third parties. The success of the financings for the first two trains convinced mezzanine lenders to finance the sponsor's equity in the third train, said Cliff Thompson, vice-president of finance at Freeport LNG Development in Houston.

"It's a much better structure for us," Thompson said of the third train, "because we get to keep 100% of a project that we really like."

On train one, Freeport LNG obtained support from export credit agencies. But train two relied solely on commercial bank debt. The debt structure of train two - a seven-year mini-perm - formed the basis for train three.

"All the hard work and brain damage had been done to structure train two, which established the framework for how train three was implemented," said Rohit Chaudhry, partner at Chadbourne & Parke in Washington, DC.

Compared to the deals for the first two trains, which took more than a year, the financing process for train three was comparatively swift - less than four months. Freeport LNG had previously obtained necessary regulatory approvals from the US Federal Energy Regulatory Commission (FERC) and the US Department of Energy. And it had signed tolling agreements for all three trains by September 2013, which locked in contracted cashflows before the collapse in global oil and gas prices.

Mezzanine structure

The mezzanine debt sits at the holding company level of train three, and is subordinate to the senior debt, which is at the project level. As is common in project finance, if the project company is unable to pay its senior lenders, those senior lenders can foreclose on the collateral.

If the project is not able to pay back its mezzanine debt, however, mezzanine lenders can step in and take the equity in train three. Senior lenders had a say in the credit requirements that mezzanine parties must possess in order to step in as equity. But senior lenders were not necessarily privy to the identity of the specific providers of the mezzanine debt.

Multiple deal participants confirmed to *IJGlobal* that IFM Investors – which owns equity in train two – arranged the mezzanine debt. Freeport LNG, IFM Investors and Macquarie (Freeport LNG's financial adviser) declined to comment on the sources of the mezzanine debt.

Senior debt

Pricing on the senior debt backing train three starts at 175bp over Libor, and steps up to 200bp upon completion of construction. The pricing is 50bp below the debt supporting Freeport train two. Substantial demand for the train three debt – which was 4.5x oversubscribed – allowed the sponsor to get favourable terms and pricing, Chaudhry explained.

Because trains two and three are structured as mini-perms, Freeport LNG will need to eventually refinance the debt packages. It most likely will look for early refinancings - during construction - in the bond markets, Thompson said. Cheniere Energy Partners has closed several bond issues to refinance debt on four liquefaction trains at Sabine Pass in Louisiana.

Like train two at Freeport LNG, debt on train three featured a hedge – known as a deal contingent hedge – that converted the floating Libor interest rate to fixed rate before financial close. Hedge providers collected a premium in exchange for agreeing to a fixed interest rate on a specific amount of debt, which allowed Freeport LNG to take advantage of a low interest rate.

The expected debt-to-equity ratio on train three's construction is 78.5:21.5, even though the total raised capital results in a ratio of 80:20. This is because the senior debt includes additional funding in case of cost overruns.

Common facilities

Financing for trains one and two supported common facilities – including control rooms, feed gas pipelines and warehouses – that train three will also use. Once the developer completes construction on train three, the project company for train three must make a one-off payment to trains one and two on the shared facilities, Thompson said. The amount of the payment will depend on the final cost of the common assets, and train three will pay that amount from financing proceeds.

Freeport LNG raised $15.5 billion across the three train financings. The sponsor will use $12.5 billion for construction, $1.5 billion to get access to Freeport regasification facility's infrastructure and land, and the remaining $1.5 billion for contingency purposes and possible cost overruns.

Train four and beyond

In mid-May 2015 Freeport LNG submitted a pre-filing request to FERC to begin environmental review on a fourth train. The developer expects to file a formal application by November 2015.

Freeport LNG is also considering a shift to a master limited partnership (MLP) ownership structure once the trains begin operations. Companies that generate income from minerals and natural resources can adopt an MLP structure, which allows entities to bypass corporate income taxes. Converting to an MLP would allow Freeport LNG to further maximise returns from its trains.

