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[Puerto Rico Bond-Trading Blitz Could Ease Path From Bankruptcy.]

- **Securities changing hands at fastest pace in three years**
- **Those buying at record lows may be willing to settle for less**

Since Hurricane Maria struck Puerto Rico almost two months ago, investors have unloaded the island's bonds at the fastest pace in three years, pushing prices to one new low after another.

The selloff caused at least a fifth of the government's $12 billion of general-obligation bonds to change hands, a shift that could help hasten Puerto Rico's emergence from its record-setting bankruptcy. That's because those who bought near now record lows may be willing to settle for far less than hedge funds and others that rushed in before the financial collapse.

"The market's resetting for the potential for a resolution," said Rob Amodeo, who manages $25 billion as head of municipals at Western Asset Management. "That's where the trade is headed and you needed to get there because there's not enough capital to repay bondholders."

The bankruptcy in May initiated a court battle that's expected to last for months as Puerto Rico faces off against owners of $74 billion of debt backed by various legal protections and sometimes competing claims to the government's cash. The outcome was made even more uncertain by the devastation caused by the hurricane, which has left much of the island still without power, crippled the economy and caused an estimated 100,000 residents to leave. Governor Ricardo Rossello has asked for $94 billion of federal aid.

On Wednesday, Puerto Rico's most actively traded bonds dropped to as little as 24 cents on the dollar after the lawyer for the government's financial oversight board said that the island may need to suspend debt payments for five years. That price is the lowest since the securities were issued in 2014 and less than half what it was in mid-September.

Speculation that bondholders face an even deeper hit has pushed Puerto Rico debt trading to a three-year high. The trailing 30-day daily average of debt traded was $455 million on Wednesday, the most since at least September 2014, according to data compiled by Bloomberg.

The rout has pushed bond prices closer to what the territory can afford to repay, said Brad Setser, a Treasury Department official under President Barack Obama who helped with the Puerto Rico rescue law enacted last year. Some securities, such as those issued by the highway and infrastructure agencies, are trading for pennies on the dollar.

"It is certainly helpful that market prices now reflect more realistic expectations about Puerto Rico's capacity to pay," said Setser, who is now a senior fellow at the Council on Foreign Relations.

Even so, an investor buying at record lows may still fight for as much as they can get, he said. "Just because you buy at a low price doesn't necessarily mean that you're willing to settle for a low recovery."

Bondholders’ expectations will play an important role in how long Puerto Rico’s various agencies must remain under court protection. To end the bankruptcy, the federal oversight board in charge of the case must convince a judge to approve a debt-cutting plan for each agency, including the central government. Creditors will get to vote on those plans, and U.S. Judge Laura Taylor Swain will take the result into account when deciding whether to approve Puerto Rico’s proposals.

Before Maria, Puerto Rico said it could allocate $8 billion for debt service payments through 2026, far short of the $33.4 billion that’s owed. The government plans to revise those plans by the end of next month to account for the storm, which Puerto Rico’s federal oversight board estimates may leave a budget shortfall of as much as $21 billion over the next two years.

Bondholders have sold about $2.5 billion of commonwealth general obligations to securities dealers since Maria made landfall in Puerto Rico, according to data compiled by Bloomberg. Those maturing in 2035, the most heavily traded security, changed hands Wednesday at an average of 25 cents on the dollar, down from 56.7 cents before the storm, Bloomberg data show. Many of those bonds were initial sold to hedge funds for 93 cents in March 2014, with the firms wagering that the government wouldn’t be allowed to go broke.

“Now they’re capitulating and selling to the distressed traders,” said Western Asset’s Amodeo, whose firm doesn’t hold any Puerto Rico debt and has sat on the sidelines despite the recent price drop.

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