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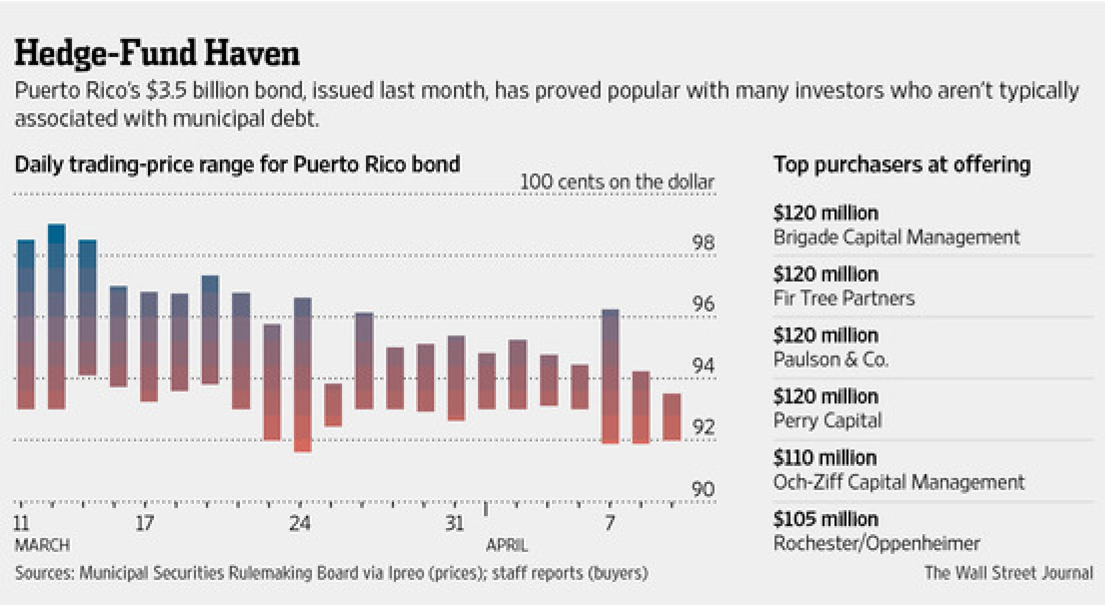
[WSJ: Big Hedge Funds Roll Dice on Puerto Rico Debt.](#)



Several large hedge funds doubled down on Puerto Rico in last month's giant bond sale despite the U.S. territory's financial struggles, according to confidential documents reviewed by The Wall Street Journal.[Och-Ziff Capital Management](#) LLC, Fir Tree Partners, Perry Capital LLC and Brigade Capital Management each bought more than $100 million of the bonds, according to a list of buyers of the $3.5 billion deal. The list doesn't show whether the firms continue to hold the bonds, which carried junk credit ratings, or whether they sold some or all of their purchases afterward.John Paulson's Paulson & Co. also purchased more than $100 million of the deal. It isn't clear whether Mr. Paulson owned Puerto Rico debt before. His firm invested in a Puerto Rico hotel earlier this year.Hedge funds and other nontraditional buyers of municipal bonds bought around 70% of the deal when it was offered, according to calculations based on the document—an atypically high level for municipal-bond offerings. Many investors said they were drawn by the high yields and discounted price, though market participants said another major draw for buyers was the prospect of boosting the value of their existing investments in the island.Junk-rated municipal debt is rare and most municipal debt is bought by mutual funds and individual investors. Many mutual funds can't buy debt rated below investment grade.Puerto Rico officials and the banks leading the bond sale— [Barclays](#) PLC, RBC Capital Markets LLC and Morgan Stanley—pitched the March 11 offering as a critical step in improving the island's finances. Since then, prices of Puerto Rico's bonds have fallen amid concerns it may restructure some of its debt, hurting some investors who purchased bonds at the offering price.Some hedge funds are known for their short-term investment strategies. If the island's debt investors sell in and out of their bonds, it could push up Puerto Rico's borrowing costs.Several large hedge funds doubled down on Puerto Rico in last month's giant bond sale despite the U.S. territory's financial struggles. An electronic billboard on the Morgan Stanley building near New York's Times Square congratulates the territory on its sale. ReutersThe list, assembled by the banks that underwrote the March offering, offers a rare window into how Wall Street doles out securities in hot offerings to its customers.The identities of debt buyers typically aren't known to market participants. Regulations require banks that coordinated the deal to distribute the list to other banks that helped distribute the bonds, but it wasn't meant to reach investors. Information about who owns what securities and when is valuable to traders when making decisions about buying and selling their holdings.“This is troublesome to know that all those names in any…deal are circulating because it gives an insight into what people are doing,” especially for private funds that aren’t required to report holdings, said Peter Hayes, head of the municipal-bond group at BlackRock Inc., which bought some of the Puerto Rico deal.Some of the firms including Och-Ziff, which bought $110 million of the offering, subsequently sold part of their holdings on the day of the deal, said a person familiar with the matter. Others including Perry Capital, which bought $120 million, are sticking with their investment, another person said.Brigade, Fir Tree, Perry and mutual-fund manager OppenheimerFunds were adding to already large investments in Puerto Rico’s debt. Many of these firms bought Puerto Rico debt over the past year at steeply discounted prices and higher yields, said people familiar with the matter. Puerto Rico bonds that were trading at distressed prices early in the year rose in price when it appeared the new bond sale would succeed, replenishing the government’s coffers.Warning signs are cropping up. Puerto Rico’s finance arm hired restructuring lawyers from Cleary Gottlieb Steen & Hamilton LLP, sparking worries among analysts that officials are considering a debt restructuring that could lead to bondholder losses. Puerto Rico in recent weeks also hired restructuring advisers at FTI Consulting Inc. who are working on the operations of utility and highway units, people familiar with the matter said. Puerto Rico previously had said it was working with a unit of Millstein & Co., a financial adviser that specializes in restructuring.Puerto Rico officials have said publicly that they intend to honor their obligations, and they have worked to change the island’s pension system and raised new taxes to increase revenues.Bill Black, who helps oversee the $6.2 billion Invesco High Yield Municipal Fund, said investors are asking “what the commonwealth is really intending now that they seem to have a restructuring financial adviser and a restructuring attorney engaged.”Mr. Black said his fund bought some of Puerto Rico’s new bonds last month, but sold the debt within a week as prices rose. The fund still owns some other Puerto Rico debt. His firm bought $14.5 million of the March bond.Other buyers of the March 11 bond included the biggest municipal-bond mutual-fund holder of Puerto Rico debt, OppenheimerFunds, as well as Harvard University and the treasury unit of publisher Gannett Co. Several insurance companies, banks and retail investors also were allotted chunks, according to the document.The 21-year bonds sold on March 11 recently were trading at around 92 cents on the dollar, to yield 8.839%, after trading up to about 99 cents on the dollar in the first few days on the market. The bonds originally were sold at 93 cents on the dollar to yield 8.727%, according to MSRB data.Puerto Rico officials declined to comment.Investors have sold $1.7 billion of the bond since Puerto Rico issued it, according to data from the Municipal Securities Rulemaking Board. It isn’t clear how much of that debt was sold by hedge funds, and some of those transactions reflect trades by investors who purchased the bonds from original buyers of the debt.MATT WIRZUpdated April 9, 2014 8:41 p.m. ET—Mike Cherney, Al Yoon and Katy Burne contributed to this article.**Write to** Matt Wirz at matthieu.wirz@wsj.com

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