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Puerto Rico May Get Help from Unlikely Source: Its Lenders.

After wondering for seven sweltering days who would pay to rebuild their ruined electrical grid, Puerto Ricans got a possible answer from an unexpected source on Wednesday: investors holding the island power company's defaulted bonds.

The bondholders, a group that includes mutual-fund giants and hedge funds, have offered to lend Puerto Rico $1 billion to pay for urgent repairs and to cancel $150 million of the power company's outstanding debt in the process.

Because of how it is structured, the proposal by the bondholders could help them even as it helps Puerto Rico.

The loan would not be enough to replace the island's aged electrical system, which was knocked out by Hurricane Maria, leaving more than three million people without power and, in some cases, water.

But the bondholders say that in addition to covering immediate repairs, their offer would allow Puerto Rico to apply for federal grants for long-term rebuilding that would not have to be repaid.

Various federal agencies offer such grants after natural disasters, but require recipients to put up a share of a project's cost, usually 25 percent. The Federal Emergency Management Agency typically coordinates such grants.

Puerto Rico's power company, known as Prepa, was insolvent even before the hurricane hit and would have a hard time producing such upfront money on its own.

"This capital commitment will provide bridge financing and matching funds as required by FEMA legislation," said Stephen Spencer, a managing director at the investment bank Houlihan Lokey who is the bondholder group's financial adviser in Puerto Rico's bankruptcy case.

Mr. Spencer said the package offered by his group, which includes Franklin Templeton, Knighthead Capital Management and OppenheimerFunds, would qualify Prepa for at least $3 billion in federal grants, and possibly as much as $9 billion.

The potential benefits for the bondholders are tied to the package being offered as debtor-i--possession financing, which is normally used to keep bankrupt corporations afloat during Chapter 11 cases.

Debtor-in-possession financing requires court approval because it increases a bankrupt party's total insolvency. Parties that extend such financing typically jump to the top of the creditors list in a bankruptcy, notable given that some of Puerto Rico's creditors are fighting one another over where they rank on that list.

Not only would the bondholders' loan take priority over some of Puerto Rico's other debts, but it would also offset some losses the bondholders may face if the original debt were not repaid in full.

In a statement, Natalie Jaresko, the executive director of the federal board overseeing Puerto Rico's finances, said: "We welcome and appreciate the expression of support from creditors. The board will carefully consider all proposals in coordination with the government."

With about $9 billion in outstanding debt, Prepa is among the most troubled branches of a Puerto Rican government saddled with around $74 billion in total debt, mostly in municipal bonds. Prepa declared itself insolvent in 2014 and stopped making debt payments, leading bondholders to start negotiations to slow the original repayment schedule.

A preliminary agreement to restructure a sizable portion of Prepa's debt was reached in September 2014 with terms that included a rate increase for its customers. Much has changed since then, though, and a final restructuring deal is in limbo.

Last year, an investigation by Puerto Rico's Senate uncovered evidence of a cabal within Prepa that appeared to have cheated the island's 1.5 million ratepayers out of more than $1 billion. The scheme involved buying cheap, dirty sludge to burn in the island's power plants, but billing ratepayers for clean, high-grade fuel.

Many Puerto Ricans now associate Prepa with corruption, abuse and a $9 billion debt they believe they should not have to repay.

Prepa was not originally included when Puerto Rico sought court protection from its creditors in May, under a special law for insolvent territories, known as Promesa. The power company filed its own case in July, under the guidance of the federal oversight board, which wants a more drastic restructuring than the bondholders had negotiated.

Under the terms of the $1 billion loan being offered by bondholders, Puerto Rico would not have to make principal or interest payments for two years. During that time, interest would accumulate at a variable rate starting at about 5.5 percent and following market rates up or down. The bondholders also offer not to charge an early payment penalty should Puerto Rico find a better deal after accepting the loan.

The $150 million in canceled debt would come via an arrangement known as a roll-up, in which participating bondholders would exchange $1 billion of outstanding defaulted bonds for new, viable bonds with a face value of $850 million.

The deal would have to be approved by both the Puerto Rican government and Judge Laura Taylor Swain of Federal District Court in New York, who is presiding over Puerto Rico's case.

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