CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas Holtz-Eakin, Director

November 13, 2003

Honorable John McCain
Chairman
Committee on Commerce, Science,
and Transportation
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

As you requested in your letter of November 6, 2003, the Congressional Budget Office has estimated the cost of the following two alternatives to the Air Force's proposal to lease 100 Boeing 767 aircraft for use as aerial refueling tankers:

- Lease 20 tanker aircraft and buy another 80 under the negotiated financing arrangement, and

- Lease 20 tanker aircraft and buy another 80 using separate new contracts.

As presented in our testimony on September 4, 2003, and our letter to Senator Warner dated October 16, 2003, CBO estimates it would cost $21.5 billion to lease 100 tankers and then purchase them at the end of each lease period.

Either of the two alternatives described above would cost less than the Air Force's original plan. CBO estimates that if the Air Force leased 20 tankers and purchased another 80 upon delivery, using the financing arrangement in its original proposal, acquisition costs would total $18.3 billion, saving $3.2 billion when compared to the original lease proposal. (In a letter to Senator Warner dated November 5, 2003, the Department of Defense (DoD) indicated it would purchase no more than 13 tanker aircraft a year and delay the delivery of the 100th tanker until 2014. CBO used this new delivery schedule in estimating the cost of the alternatives you specified.)

Alternatively, if the Air Force leased 20 tankers and purchased another 80 using separate contracts for the two transactions, CBO estimates acquisition costs would total $16.2 billion, saving $5.3 billion when compared to the original lease proposal. Specific details about each alternative and our cost estimates follow.

The Air Force's Original Proposal. As CBO discussed in its testimony before the Senate Committee on Armed Services, the Air Force's original lease proposal is a complex financing arrangement that significantly increases the cost to acquire the tankers.[1] Boeing and the Air Force have established a special-purpose entity (the KC-767A USAF Tanker Statutory Trust 2003-1) to execute the proposed arrangement and to finance the acquisition of the aircraft. Under the financing plan proposed by the Air Force and Boeing, the Trust—acting on behalf of the government—would buy 100 KC-767A tankers from Boeing and would borrow money to make progress payments to Boeing during the construction period for each group of aircraft. Since the Trust is an instrument of the government, the government would effectively be buying the aircraft (via the Trust) and then leasing them to itself.

As Boeing completes construction of each group of tanker aircraft, the Trust would issue bonds in the commercial bond market to pay Boeing for the remainder that it is owed for the aircraft, repay the principal on the construction loans, and pay interest on the construction loans. The Trust would use the Air Force's lease and purchase payments to redeem the bonds. Because this special-purpose entity would borrow money at rates that are higher than U.S. Treasury rates, acquisition costs would be greater than if the Air Force purchased some or all of the aircraft directly from Boeing. CBO estimates that acquisition costs would total $21.5 billion over the 2004-2017 period (or $14.9 billion in present-value terms).

Lease 20 Tanker Aircraft and Buy Another 80 under the Negotiated Financing Arrangement. Under the first alternative you requested, the Air Force would sign the negotiated contract to acquire 100 tankers and indicate that it would purchase the last 80 aircraft at the time of delivery rather than waiting until the end of the six-year lease period to do so. CBO assumes that all tanker aircraft acquired in this manner would be bought at the prices negotiated in the original contract. If the Air Force pays for the 80 tankers at delivery, the Trust would borrow the money required to finance the construction of the aircraft, and would include the additional interest costs—totaling approximately $0.7 billion—in the purchase price of the aircraft. CBO estimates that the acquisition costs for this alternative would total $18.3 billion (or $13.7 billion in present-value terms), saving $3.2 billion compared to the original lease proposal (see table below).

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1. Statement of Robert A. Sunshine, Assistant Director for Budget Analysis, before the Committee on Armed Services, United States Senate, September 4, 2003.

COMPARISON OF ALTERNATIVES TO ACQUIRE 100 KC-767A AIRCRAFT
(In billions of dollars)

Alternatives	Total Acquisition Cost	Present Value
Original Acquisition Plan	21.5	14.9
Lease 20 Tankers and Buy 80 under the Negotiated Financing Arrangement	18.3	13.7
Lease 20 Tankers and Buy 80 under Separate New Contracts	16.2	12.6

Lease 20 Tanker Aircraft and Buy Another 80 Using Separate New Contracts. Implementing this alternative would require the Air Force to negotiate two new contracts—one to lease the first 20 tankers and another to purchase the remaining 80 aircraft. The price specified in the existing contract includes an unusual inflation adjustment and several other costs that are unique to this lease arrangement. If the Air Force were purchasing the tankers outright and following standard budgeting procedures, it could negotiate a contract that adjusts prices at the same inflation rate it uses for other aircraft procurement programs. CBO estimates that the higher inflation assumption in the existing contract increases the average cost of purchasing aircraft through the lease contract by almost $11 million per plane in current dollars. Additionally, since the aircraft price specified in the existing contract includes costs that are unique to the leasing arrangement, CBO believes that the price for the tankers procured under the multiyear procurement authority could be reduced by eliminating costs such as trust expenses, lease administration fees, and the costs for issuing bonds required to finance the lease.

If Boeing's nonrecurring costs were allocated to the first 20 tankers delivered under the lease contract, and if the Air Force made progress payments to Boeing to finance the construction of the purchased aircraft, CBO estimates that this alternative would cost $16.2 billion (or $12.6 billion in present-value terms), saving $5.3 billion compared to the Air Force's original proposal.

If you wish further details, we will be happy to provide them. The CBO staff contact is David Newman.

Sincerely,

Douglas Holtz-Eakin
Director

cc: Honorable Ernest F. Hollings
Ranking Member

Honorable John W. Warner
Chairman, Senate Committee on Armed Services

Honorable Carl Levin
Ranking Member

Honorable Duncan Hunter
Chairman, House Committee on Armed Services

Honorable Ike Skelton
Ranking Member

Honorable Don Nickles
Chairman, Senate Committee on the Budget

Honorable Kent Conrad
Ranking Member

Honorable Jim Nussle
Chairman, House Committee on the Budget

Honorable John M. Spratt Jr.
Ranking Member

Honorable Ted Stevens
Chairman, Senate Committee on Appropriations

Honorable Daniel K. Inouye
Ranking Member, Subcommittee on Defense
Senate Committee on Appropriations

Honorable Jerry Lewis
Chairman, Subcommittee on Defense
House Committee on Appropriations

Honorable John P. Murtha
Ranking Member