

October 16, 2003

Honorable John W. Warner
Chairman
Committee on Armed Services
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

As you requested in your letter of September 25, 2003, the Congressional Budget Office (CBO) has evaluated the Department of Defense's response to your request that it examine alternative strategies for acquiring 100 Boeing KC-767A tanker aircraft. According to the department's analysis, implementing the options described in its response would save from \$0.8 billion to \$5.5 billion in acquisition costs when compared to its initial proposal to lease and subsequently purchase 100 KC-767A tanker aircraft.

While the Department of Defense (DoD) continues to describe the proposed financing arrangement as a lease (and for consistency, CBO uses the same term to refer to the proposal), CBO believes the proposed transaction would not be a lease, but rather a purchase of the tankers by the federal government, because the special-purpose entity that has been established to buy the aircraft would be substantially controlled by and act on behalf of the federal government. This arrangement is also significantly more costly than acquiring the tankers through the normal appropriation and procurement process. As a result, the more tankers the Air Force purchases outright, the less costly the acquisition will be.

The least-expensive strategy would be a direct purchase of all of the tankers. We estimate that a straightforward purchase of 100 tankers under a new contract that takes full advantage of market conditions and the department's unique position as a large buyer to obtain the best price from Boeing would cost \$14.8 billion in current dollars, a savings of \$6.7 billion compared to the proposed financing arrangement.

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After reviewing the department's analyses of alternative acquisition strategies, CBO concludes that the department's estimates of the savings in total acquisition costs for options that could be implemented using the negotiated contract are accurate. However, CBO finds that the department's estimate of the savings in total acquisition costs for the option in which the Air Force would lease 25 tankers and purchase 75 more under two new contracts understate the savings by approximately \$2 billion, because its estimate is based on the original contract, which includes terms and conditions that are unique to this lease arrangement and increase the costs of acquiring the tankers.

The department points out that the long-term costs of each alternative have to be weighed against short-term funding requirements and the timely acquisition of the aircraft. In the department's view, options that use the leasing mechanism offer an advantage because they would allow DoD to defer the requirement for budget authority and outlays since the financing arrangement would be recorded as an operating lease. CBO continues to believe that the proposal negotiated by the Air Force, or any option that might take advantage of the leasing mechanism, fails to meet the conditions for an operating lease specified in the *Congressional Scorekeeping Guidelines*, and in OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, and that recording such transactions as an operating lease would be at odds with standard government accounting principles. We believe that, if recorded properly, the budget authority and outlays for the Air Force's leasing arrangement, or any hybrid lease and purchase proposal, would be similar to the amounts required for a direct purchase in both magnitude and timing.

The enclosed report provides CBO's analysis. If you wish further details, we will be happy to provide them. The staff contact is David Newman.

Sincerely,

Douglas Holtz-Eakin
Director

Enclosure

cc: Honorable Carl Levin
Ranking Member

Honorable Duncan Hunter
Chairman, House Committee on Armed Services

Honorable Ike Skelton
Ranking Member

Honorable Don Nickles
Chairman, 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

Honorable John McCain
Chairman, Senate Committee on Commerce,
Science, and Transportation

Honorable Ernest F. Hollings
Ranking Member

Assessment of the Department of Defense's Analysis
of Alternative Strategies to Acquire 100
Boeing Tanker Aircraft

Congressional Budget Office

October 16, 2003

Summary

On September 4, 2003 the Senate Committee on Armed Services asked the Department of Defense (DoD) to examine alternative strategies for acquiring 100 Boeing KC-767A tanker aircraft. In its response dated September 22, 2003, DoD analyzed seven alternative acquisition strategies—six that could be implemented using the existing contract, and one that would require negotiating new contracts. According to the department's analysis, implementing these options would save from \$0.8 billion to \$5.5 billion in acquisition costs when compared to its initial proposal to lease and subsequently purchase 100 tanker aircraft.

While DoD continues to describe the proposed financing arrangement as a lease (and for consistency, CBO uses the same term to refer to the proposal), CBO believes the proposed transaction would not be a lease, but rather a purchase of the tankers by the federal government, because the special-purpose entity that has been established to buy the aircraft would be substantially controlled by and act on behalf of the federal government. This arrangement is also significantly more costly than acquiring the tankers through the normal appropriation and procurement process. As a result, the more tankers the Air Force purchases outright, the less costly the acquisition will be. Moreover, CBO estimates that savings for any option that would involve purchasing tankers could be even larger if the department negotiated a new contract for the purchase because the current contract includes terms and conditions that are unique to the lease arrangement and that increase the costs of acquiring the tankers.

The least-expensive strategy would be a direct purchase of all of the tankers. We estimate that a straightforward purchase of 100 tankers under a new contract that takes full advantage of market conditions and the department's unique position as a large buyer to obtain the best price from Boeing would cost \$14.8 billion in current dollars, a savings of \$6.7 billion compared to the proposed financing arrangement. CBO's previous estimate of \$15.9 billion for a direct purchase was higher because it assumed some of the terms and conditions under the existing contract would be incorporated in the contract for a direct purchase. CBO now believes that these conditions should not be used to estimate the costs of a direct purchase and that they could be eliminated if a new contract were negotiated.

After reviewing the department's analyses of alternative acquisition strategies, CBO concludes that the department's estimates of the savings in total acquisition costs for options that could be implemented using the negotiated contract are accurate. However, CBO finds that the department's estimate of the savings in total acquisition costs for the option in which the Air Force would lease 25 tankers and purchase 75 more under two new contracts understate the savings by approximately \$2 billion, because its estimate is based on the original contract, which includes terms and conditions that are unique to this lease arrangement and increase the costs of acquiring the tankers.

The department points out that the long-term costs of each alternative have to be weighed against short-term funding requirements and the timely acquisition of the aircraft. In the department's view, options that use the leasing mechanism offer an advantage because they would allow DoD to defer the requirement for budget authority and outlays since the financing arrangement would be recorded as an operating lease. CBO continues to believe that the proposal negotiated by the Air Force, and any of the options that take advantage of the leasing mechanism, fail to meet the

conditions for an operating lease described in the *Congressional Scorekeeping Guidelines* and in OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, and that recording these transactions as such would be at odds with standard government accounting principles. We believe that, if recorded properly, the budget authority and outlays for the Air Force's leasing arrangement, or any hybrid lease and purchase proposal, would be similar to the amounts required for a direct purchase in both magnitude and timing. For example, CBO estimates that for all the options that could be implemented using the negotiated contract, the same amount of budget authority for acquisition costs (\$17.1 billion) should be recorded over the 2004-2008 period. For options in which the Air Force would purchase rather than lease some of the aircraft, less budget authority for interest costs would be recorded in later years.

Background

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 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.

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.

Results of CBO's Analysis

The Department of Defense presents several alternative strategies for acquiring 100 KC-767A tankers. Implementing most alternatives requires approval of the contract already negotiated. Implementing another alternative would require negotiating new contracts. In our analysis of these alternatives, and one other not considered by DoD, CBO has estimated only the acquisition costs associated with each alternative. For the sake of comparison, we exclude the costs of integrated fleet support, military construction, and operating and support costs from both CBO's and DoD's analysis, since those costs are would be roughly the same for all alternatives over the life-cycle of the aircraft. In its analysis, DoD did not include the imputed cost for self-insurance for any aircraft it purchases rather than leases. In order to present comparable figures, CBO also excluded such insurance costs, but notes that including them would add \$0.3 billion to the cost of purchasing 75 tankers and \$0.4 billion to the cost of purchasing 100 tankers. All costs are presented in current dollars unless otherwise stated.

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

Alternatives That Could Be Implemented Using the Negotiated Lease Contract

The Department of Defense's response describes the following six alternatives that could be implemented under the negotiated lease contract:

- Leasing 100 tankers and then purchasing them at the end of the lease period (the original proposal);
- Signing a lease for 100 tankers and planning to allocate an additional \$2 billion² in future budget authority over the 2008-2009 period to purchase 16 of the aircraft at the time of delivery;
- Signing a lease for 100 tankers and planning to allocate an additional \$2.4 billion³ in future budget authority over the 2008-2011 period to purchase 26 of the leased aircraft at the time of delivery;
- Leasing 25 tankers and purchasing another 75 tankers at the time of aircraft delivery beginning in 2009;
- Leasing 25 tankers and purchasing another 75 tankers at the time of order beginning in 2005; and
- Purchasing 100 tankers at the time of order.

As presented in our testimony on September 4, 2003, CBO estimates it would cost \$21.5 billion to lease 100 tankers and then purchase them at the end of each lease period. The options presented by the department would cost less than its original plan. For instance, CBO estimates that the alternatives whereby the Air Force would sign the lease for 100 tankers but purchase some of the leased aircraft before the start of the lease period would cost between \$20.3 billion and \$20.8 billion, saving between \$700 million and \$1.2 billion when compared to the original lease proposal (see table on next page). Other options, specifically those in which the Air Force would purchase 100 aircraft or lease 25 aircraft and purchase another 75 aircraft, would offer more sizable savings when compared to the original lease proposal. They would cost between \$16 billion and \$18 billion over the 2004-2017 period and would save between \$5.5 billion and \$3.5 billion, respectively. On a net-present-value basis, those savings would amount to about \$1 billion. Specific details about each proposal and our cost estimates follow.

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2. The additional amount required is net of savings from avoiding lease payments. The gross cost to purchase aircraft under this option is \$2.6 billion.
 3. This additional amount is also net of savings from avoiding lease payments. The gross cost to purchase aircraft under this option is \$4.4 billion.

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

| Alternative | DoD Estimate of Acquisition Costs | CBO Estimate | | | Savings from Proposed Lease (Present Value) |
|---|---|----------------------|--------------------------------------|---|--|
| | | Acquisition Costs | Savings from Proposed Lease | Present Value of Acquisition Costs | |
| OPTIONS USING THE NEGOTIATED LEASE CONTRACT | | | | | |
| Lease 100 Tankers Under the Existing Contract | 21.5 | 21.5 | n.a. | 14.9 | n.a. |
| Sign Lease for 100 Tankers and Purchase 16 Leased Tankers Early | 20.8 | 20.8 | -0.7 | 14.7 | -0.2 |
| Sign Lease for 100 Tankers and Purchase 26 Leased Tankers Early | 20.3 | 20.3 | -1.2 | 14.6 | -0.3 |
| Lease 25 Tankers and Purchase Another 75 at Time of Delivery | 18.0 | 18.0 | -3.5 | 14.0 | -0.9 |
| Lease 25 Tankers and Purchase Another 75 at Time of Order | 17.3 | 17.3 | -4.2 | 13.9 | -1.0 |
| Direct Purchase 100 Under Existing Lease Contract | 16.0 | 16.0 ^a | -5.5 | 13.8 | -1.1 |
| OPTIONS THAT REQUIRE NEGOTIATING NEW CONTRACTS | | | | | |
| Lease 25 and Purchase 75 | 18.3 | 16.3 | -5.1 | 12.7 | -2.2 |
| Direct Purchase of 100 Tankers | n.a. | 14.8 ^b | -6.7 | 11.9 | -3.0 |

NOTE: n.a. = not applicable.

- a. CBO previously estimated that a direct purchase of 100 tankers using traditional multiyear procurement procedures would cost \$15.9 billion. The option shown in this table differs from the procurement CBO analyzed in its previous report because the scheduling and escalation of progress payments under the negotiated contract differ somewhat from the traditional multiyear procurement CBO had assumed; that change adds \$0.5 billion to the cost. On the other hand, the previous estimate of the cost of a direct purchase included \$0.4 billion for the imputed cost of self-insurance. This cost is not included in CBO's or DoD's estimate of \$16.0 billion for a purchase using the current lease contract.
- b. CBO's latest estimate of the cost of a direct purchase under a new contract is \$1.2 billion less than our previous estimate of \$15.9 billion. The latest estimate excludes costs that are unique to the leasing arrangement and implicit insurance costs that were previously included to provide comparability with the leasing arrangement.

Lease 100 Tanker Aircraft. CBO estimates that implementing the terms of the original leasing contract would cost \$21.5 billion over the 2006-2017 period, or \$14.9 billion expressed in present-value terms. This option is the most expensive of the alternatives discussed. See CBO's testimony of September 4, 2003, before the Senate Armed Services Committee titled "*Assessment of the Air Force's Plan to Acquire 100 Boeing Tanker Aircraft*" for more information on CBO's evaluation of the proposal and its estimated costs.

Sign Leases for 100 Tankers With the Intent to Purchase Some Aircraft at the Time of Delivery. Under these two alternatives, DoD would purchase rather than lease some of the tankers when they are delivered. Under the first alternative, DoD would purchase 16 tanker aircraft at the time of delivery in 2008 and 2009. CBO estimates that this option would cost \$20.8 billion, or \$14.7 billion in present-value terms.

Under the second alternative, DoD would purchase 26 tanker aircraft at the time of delivery (over the 2008-2011 period). CBO estimates that acquisition costs under this proposal would total \$20.3 billion over the 2004-2017 period, or \$14.6 billion in present-value terms.

If the proposed leasing transactions are recorded in the budget as operating leases, both alternatives would require about \$2 billion in additional budget authority over the 2008-2010 period when compared to the payments under the original lease proposal. That decision would, however, depend on whether future Administrations or future Congresses would allocate and appropriate the necessary funds. The Air Force or DoD might have to identify budgetary offsets from other defense programs in the Future Years Defense Program, and protect those funds against the demands for other pressing needs. There is no assurance that such funds would be readily available to purchase the tankers from 2008 through 2010.

Lease 25 Tankers and Buy 75 Under the Existing Contract. DoD analyzed two options for leasing 25 tankers and purchasing the remaining 75 aircraft under the original contract. (The department also analyzed an option to lease 25 tankers and purchase 75 more using new contracts.) The purchase under the existing contract would be made either from the Trust, at the time the aircraft are delivered, or from Boeing, when they are ordered. Implementing either option would save about \$4 billion relative to the current financing plan—or about \$1 billion on a net-present-value basis.

If, after leasing 25 tankers from the Trust, the Air Force were to purchase the remaining 75 aircraft from the Trust, the costs would total \$18.0 billion, or \$14.0 billion in present-value terms. The total cost would be \$0.7 billion less if the Air Force purchased the remaining 75 tankers directly from Boeing because the purchase price for the 75 additional tankers would not reflect the higher interest costs that the Trust would incur to finance the construction of the aircraft.

Buy 100 Tankers Using the Current Contract. The Air Force could also buy all 100 KC-767A tankers at the time of order at the price specified in the current contract. This approach would offer significant savings relative to the current acquisition plan, and could be implemented without renegotiating the contract. CBO estimates that the acquisition costs for implementing this proposal would total \$16 billion over the 2004-2008 period, or \$13.8 billion in present-value terms. CBO previously estimated that a direct purchase of 100 tankers using traditional multiyear procurement

procedures would cost \$15.9 billion. This option differs from the procurement CBO analyzed in its previous report because the scheduling and escalation of progress payments under the negotiated contract differ somewhat from the traditional multiyear procurement CBO had assumed; that change adds \$0.5 billion to the cost. On the other hand, the previous estimate of the cost of a direct purchase included \$0.4 billion for the imputed cost of self-insurance. This cost is not included in CBO's or DoD's estimate of \$16.0 billion for a purchase using the current lease contract.

Alternatives That Would Require Negotiating New Contracts

DoD analyzed one alternative approach to acquire 100 tankers that would require negotiating two new contracts—one to lease 25 tanker aircraft and another one to purchase the remaining 75 aircraft—but pointed out that doing so would delay the initial program start by one year. CBO also evaluated one other approach that the department did not address—negotiating a new contract for a direct purchase of all 100 tankers.

CBO believes that the department could significantly reduce the cost of purchasing aircraft by negotiating new contracts for two reasons. First, the aircraft price specified in the contract includes costs that are unique to this lease arrangement and that should not be included in the price of aircraft that are not leased. Second, new negotiations might afford the Air Force an opportunity to bargain for a better price.

The price specified in the existing contract includes an unusual inflation adjustment and several other costs that are unique to this lease arrangement. In particular, under the negotiated lease contract, the price for the tankers increases by three percent each year after 2002. By contrast, the inflation rate specified by DoD for all other Air Force aircraft procurement programs is less than two percent each year. If the Air Force were purchasing the tankers outright and following standard budgeting procedures, it would budget for inflation at the same rate it uses for other aircraft procurement programs. CBO estimates that the higher inflation assumption increases the average cost of purchasing aircraft through the lease contract by almost \$11 million per plane in current dollars. Other charges included in the price of the tanker are costs for issuing the bonds required to finance the lease, operating expenses for the special-purpose entity, and lease administration fees. The Air Force was unable to provide an estimate of these expenses, but based on analysis of similar financial arrangements by DoD and other government agencies, financial reports from aircraft leasing firms, and conversations with financial-sector experts, CBO estimates that these other expenses that are unique to the leasing arrangement would add about \$1 million to the cost of each tanker.

Since the negotiated price in the current contract includes expenses that would not be incurred if the tankers were purchased outright, CBO believes that, if the department were willing to accept a delay in fielding the aircraft, reopening negotiations would offer the opportunity to eliminate those lease costs from the price and potentially negotiate more favorable prices. In fact, testimony given before the House and Senate Armed Services Committees, suggests that the Air Force may not have taken

full advantage of market conditions and its unique position as a large buyer to obtain the best price from Boeing.⁴

Tanker deliveries might be delayed relative to the original lease proposal if the Air Force negotiates new contracts with Boeing, due to the time required for the parties to agree to new terms and for the Congress to authorize a direct purchase and appropriate the necessary funds. In estimating the costs of leasing 25 tankers and purchasing an additional 75 planes using two new contracts, the Air Force assumed that the aircraft would be delivered under the following schedule—10 in 2007, 15 each in 2008 and 2009, and 20 annually over the 2010-2012 period. CBO also believes that this delivery schedule is feasible and used the same schedule in estimating the costs of using two new contracts for leasing and purchasing. In estimating the cost of directly purchasing 100 tankers under a new contract, CBO used the following aircraft delivery schedule—10 planes in 2008, 20 aircraft each year over the 2009-2012 period, and 10 aircraft in 2013, assuming the Congress would provide the authorization for a direct purchase as part of the National Defense Authorization Act for Fiscal Year 2005. However, given the high level of interest in acquiring new tankers, it might be possible to provide Congressional authorization and complete new contract negotiations in time to ensure delivery of the first tanker by the end of 2006.

Lease 25 Tankers and Buy 75 Under New Contracts. The Department of Defense estimated that the acquisition costs for this proposal would total \$18.3 billion. The department estimated the average price for the leased aircraft (\$160.7 million in 2002 dollars) based on the average unit price of the first 25 tankers consistent with the price in the current lease contract and the assumption that all of the nonrecurring engineering costs that are attributable to specific Air Force requirements would be charged to these aircraft. The department also estimated the prices for the purchased aircraft (\$125.3 million in 2002 dollars) based on an average unit price of the last 75 aircraft consistent with the current lease contract and the assumption that building the tankers using two contracts would result in production inefficiencies that would increase the price of the purchased tankers by a few million dollars each.

However, CBO believes the Air Force's analysis overstates the costs by using the prices negotiated under the lease contract to estimate the cost of the purchased aircraft, and by assuming that production inefficiencies arise from having separate contracts. Most ongoing acquisition programs purchase equipment on an annual basis using separate contracts, without introducing production inefficiencies. CBO believes that negotiating separate contracts would not cause a break in the production line and thus would not increase production costs.

CBO estimates that the acquisition costs to lease 25 tankers and purchase the remaining 75 aircraft using two new contracts would total \$16.3 billion, saving \$5.1 billion when compared to the original lease proposal. On a net-present-value basis, the savings would be more than \$2 billion. (Part of the reason that the present value of the savings from this option is larger than that of savings from alternatives that employ the existing contract is that aircraft deliveries would be delayed slightly,

4. Statement of John L. Plueger, President and Chief Operating Officer, International Lease Finance Corporation, before the Committee on Armed Services, U.S. House of Representatives, July 23, 2003. Statement of Dr. J. Richard Nelson, Assistant Director, Cost Analysis and Research Division, Institute for Defense Analyses, before the Committee on Armed Services, United States Senate, September 4, 2003.

thus delaying some expenditures.) In estimating these costs, CBO assumed that appropriations would be provided to pay for the Air Force's share of nonrecurring engineering costs (about \$640 million) in 2005, at the outset of the acquisition cycle. While this approach would increase the up-front funding requirement, it would lower total acquisition costs by reducing the amounts that the Trust would need to borrow. In addition, this approach would eliminate the risk that Boeing might not fully recover its development expenses.

Using the same assumptions for progress payments that we used in our previous analysis of the Air Force's financing proposal and subtracting the development costs and the costs that are unique to the lease contract from the price of the planes, CBO estimates that the average price of the leased planes would be \$140 million (in 2002 dollars) and the average price of the purchased aircraft would be \$118 million (in 2002 dollars), lower than the Air Force's estimate by 13 percent and 6 percent respectively.

Purchase 100 Tankers Under a New Contract. The Air Force could also negotiate a new contract for an outright purchase of 100 tankers. CBO estimates that if the Air Force were to negotiate an aircraft purchase price similar to the price in the existing lease but excluding the expenses that are unique to this leasing arrangement, the average price of the aircraft would be \$123.6 million (in 2002 dollars) and that acquisition costs for a direct purchase would total about \$14.8 billion, or \$11.9 billion in present-value terms. This approach would cost \$1.2 billion less than a purchase under the existing contract, CBO estimates. Implementing this schedule would provide fewer tankers over the 2006-2017 period. Under the proposed leasing strategy, the KC-767A inventory would average 75 planes over this period, while the deferred schedule assumed in this alternative would provide an average inventory of 63 KC-767s.

Feasibility of Separate Lease and Purchase Contracts

The Air Force has expressed concern that it might not be able to execute a separate contract for leasing 25 tankers if it were purchasing 75 tankers outright as well. The Air Force believes that investors might not purchase bonds for the leased aircraft, which by its estimate cost \$161 million per plane (in 2002 dollars), when the service would also be buying some tankers outright for \$125 million each (in 2002 dollars).

CBO believes this concern is unwarranted. The marketability of the bonds would be based on the risk that the cash flows intended to pay off the bonds might be interrupted. Buyers of the special-purpose entity's debt face two forms of risk: that the Air Force might terminate the lease early, and that the service might not purchase the leased aircraft at the end of the lease term. As pointed out in our earlier analysis, CBO believes the risks of either outcome occurring appear very low, and would not likely change if the Air Force were simultaneously purchasing tankers for a lower price.

Early termination of the lease seems highly unlikely in general, and the fact that the Air Force would be purchasing some aircraft should not increase the likelihood that it would terminate a lease for other tankers before the end of the lease term. The acquisition strategy would not change the number of tankers the Air Force requires. The Air Force would also incur significant termination charges, which it does not intend to budget for under the negotiated lease arrangement, if it chose to terminate the lease before the end of the six-year term.

It also seems highly likely that the Air Force would purchase the tankers at the end of the lease term. The tankers, which would be only six years old at that point, could be purchased for approximately \$45 million, less than a third of the cost to buy a new tanker purchased when the leased tanker was returned. Returning the leased aircraft would also result in a reduction in the tanker inventory while the Air Force waited for Boeing to produce new tankers.

In short, although it would not be as cost-effective as a direct purchase, and would provide slightly fewer aircraft over the same period than the negotiated lease, a hybrid acquisition strategy to lease 25 tankers and purchase 75 more using two separate contracts should be feasible.