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AIR FORCE DEPOT MAINTENANCE

Privatization-in-Place Plans Are Costly While Excess Capacity Exists

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The Honorable Floyd Spence
Chairman, Committee on National Security
House of Representatives

The Honorable Don Nickles
United States Senate

As requested, we reviewed the Department of Defense's (DOD) decision to pursue privatization-in-place initiatives at two major Air Force maintenance depots recommended for closure during the 1995 base realignment and closure (BRAC) process. Specifically, we reviewed the Air Force's plans to privatize-in-place depot maintenance workloads at the Sacramento and San Antonio air logistics centers and determined (1) the impact on excess depot capacity and operating costs at the remaining defense depots; (2) the cost-effectiveness of planned privatization initiatives, including the impact of delaying base closures until the year 2001; and (3) compliance with statutory requirements.

Results in Brief

As we stated in our April 1996 testimony on depot maintenance before the Subcommittees on Readiness, House Committee on National Security and Senate Committee on Armed Services, deciding the future of DOD's depot system is difficult. Depot maintenance privatization should be approached carefully, allowing for evaluation of the economic, readiness, and statutory requirements that surround individual workloads. Privatizing depot maintenance activities, if not effectively managed, including the downsizing of remaining DOD depot infrastructure, could exacerbate existing excess capacity problems and the inefficiencies inherent in underused depot maintenance capacity. Privatizing workloads in place at two closing Air Force depots does not reduce the excess capacity in the remaining depots or the private sector and consequently is not a cost-effective approach to reducing depot infrastructure.[1]

Privatizing-in-place rather than closing and transferring the depot maintenance workloads at the Sacramento and San Antonio air logistics centers will leave a costly excess capacity situation at remaining Air Force depots that a workload consolidation would have mitigated. Private industry representatives generally agree that privatization-in-place does

[1]Defense Depot Maintenance: Privatization and the Debate Over the Public-Private Mix (GAO/T-NSIAD-96-146, Apr. 16, 1996) and (GAO/T-NSIAD-96-148, Apr. 17, 1996).

not solve the excess capacity problem in the public and private sectors and is not the most cost-effective closure option.

Although the Air Force's privatization initiative for the Sacramento and San Antonio depots has not progressed far enough for us to estimate precisely costs and savings, consolidating depot maintenance workloads at remaining underused depots could result in a net savings in 2 years or less. Our work shows that transferring the depot maintenance workloads to other depots could yield additional economy and efficiency savings of over $200 million annually. These savings are in addition to the $268 million annual savings the BRAC Commission estimated could be achieved by eliminating the McClellan and Kelly infrastructures and downsizing nonmaintenance personnel. Moreover, if the workload consolidation does not occur, the remaining Air Force depots are likely to become more inefficient and more costly, unless other workloads are added, costly excess capacity is eliminated, or other efficiency and economy initiatives are successfully implemented.

Plans to delay many closure-related actions until 2001 will substantially reduce future savings envisioned by the BRAC Commission. Specifically, our analysis shows that the delay could result in a net loss of $644.4 million between 1997 and 2001 for the Air Force and $24 million for the Army.

DOD stated that it will structure the San Antonio and Sacramento privatizations to comply with existing statutory restrictions, including the 10 U.S.C. 2469 requirement that privatizing workloads valued at not less than $3 million be done using competitive procedures that include both public and private entities. Because the Department's privatization plans are still evolving, sufficient information is not available for us to assess whether the conversion plans will comply with the existing law.

Background

DOD annually spends about $15 billion—or about 6 percent of its $243 billion fiscal year 1996 budget—on depot maintenance work that involves the repair, overhaul, modification, and upgrading of aircraft, ships, ground vehicles, and other equipment. Over $4 billion is spent on Air Force systems and equipment. Most of the Air Force's depot maintenance work is performed at five depots that are located at its five air logistics centers.

Since the early 1970s, we and others have reported on the redundancies and excess capacity that exist in DOD depots and the need to downsize and improve the operational efficiency of these depots. These problems have been exacerbated in recent years by reductions in military force structure and related weapon system procurement; changes in military operational requirements due to the end of the Cold War; increased reliability, maintainability, and durability of military systems; increased maintenance performed in operational units; and increased privatization of depot maintenance workloads.

Beginning in the late 1980s, DOD—primarily through the BRAC process—reduced some of its excess capacity by closing a number of depots and transferring most workloads to remaining depots and some to the private sector. Altogether, the first three BRAC rounds (1988, 1991, and 1993) resulted in recommendations to close nine Army and Navy depots and the Air Force's Aerospace Guidance and Metrology Center.[2] Despite major force structure reductions and significant excess capacity in the Air Force depot maintenance system, none of the Air Force's five air logistics centers or the large, multi-commodity depots contained within them were recommended for closure during the first three BRAC rounds. As shown in table 1, for fiscal year 1996, the five centers reported approximately 57.2 million direct labor hours of depot maintenance capacity and accomplished about 31.5 million hours of work—leaving about 25.8 million hours of excess capacity, or about 45 percent.

Table 1: Projected Fiscal Year 1996 Workload and Excess Capacity at the Five Air Force Depots

Workload and capacity in direct labor hours

Depot	Maximum capacity	Fiscal year 1996 workload	Excess capacity Hours	Excess capacity Percent
Oklahoma City	12,863,153	7,058,083	5,805,070	45
Ogden	9,004,515	5,146,999	3,857,516	43
San Antonio	15,219,752	6,372,607	8,847,145	58
Sacramento	10,226,981	5,509,051	4,717,930	46
Warner Robins	9,912,789	7,375,889	2,536,900	26
Total	**57,227,190**	**31,462,629**	**25,764,561**	**45**

Note: Capacity and workload data was reported by the military services and certified during the 1995 BRAC process.

[2]Our report, Closing Depots: Savings, Workload, and Redistribution Issues (GAO/NSIAD-96-29, Mar. 4, 1996) contains information on the 10 depots recommended for closure during the first three BRAC rounds and provides an overview of DOD's depot maintenance system. Our report, Aerospace Guidance and Metrology Center: Cost Growth and Other Factors Affect Closure and Privatization (GAO/NSIAD-95-60, Dec. 9, 1994), addressed closure and privatization issues for that facility.

1995 BRAC Process Decisions

DOD's February 1995 report to the BRAC Commission recommended reducing excess Air Force depot maintenance capacity and costs by downsizing all five air logistics centers, including their depots. DOD estimated that this downsizing would require one-time costs of $183 million and would result in net savings of $138.7 million during the 6-year implementation period. The downsizing was to be accomplished through consolidating similar workloads, mothballing or disposing of plant equipment, and tearing down buildings. The Commission also estimated that annual savings would be $89 million after the implementation period and that the net present value of all costs and savings over a 20-year period would be $991.2 million.

The 1995 BRAC Commission concluded that DOD's downsizing approach would not adequately reduce infrastructure and overhead costs. It recommended closing the Sacramento and San Antonio centers and transferring their workloads to the remaining depots or private sector commercial activities. In making its closure and workload transfer recommendations, the Commission considered the effects on the local communities, workload transfer costs, and potential effects on readiness. It concluded that the savings and benefits outweighed the potential drawbacks. The Commission's report noted that given the significant amount of excess depot capacity and limited DOD resources, closure is a necessity. Further, closing these activities would improve the use of the remaining centers and substantially reduce DOD operating costs. The specific Commission recommendations were as follows:

- Realign Kelly Air Force Base, including the air logistics center; disestablish the defense distribution depot; consolidate the workloads to other DOD depots or to private sector commercial activities as determined by the Defense Depot Maintenance Council;[3] and move the required equipment and personnel to the receiving locations.
- Close McClellan Air Force Base, including the air logistics center; disestablish the defense distribution depot; move the common-use ground communication electronics to Tobyhanna Army Depot, Pennsylvania; retain the radiation center and make it available for dual use and/or research, or close as appropriate; consolidate the remaining workloads with other DOD depots or private sector commercial activities as determined by the Council; and move the required equipment and any required personnel to receiving locations. All other activities and facilities at the base will close.

[3]The Defense Depot Maintenance Council is a senior-level council established to advise the Deputy Under Secretary of Defense for Logistics on depot maintenance within DOD.

The Commission estimated that these recommendations would require one-time implementation costs of $822.6 million but would yield net savings of $151.2 million during the 6-year implementation period. Further, they would yield annual savings of $338.2 million after the implementation period, about $70 million of which represented depot maintenance savings. The projected depot maintenance savings were developed by assuming that the number of depot maintenance personnel could be reduced by 15 percent. The Commission estimated that the net present value of savings over 20 years, including the 6-year implementation period, would be $3.5 billion. The Commission's savings projections did not include savings from moving workloads to depots with lower labor rates, consolidating workloads in underused facilities and reducing excess capacity, increasing efficiency, and reducing the overhead rates at receiving depots.

In considering the BRAC recommendations to close the two centers, the President and the Secretary of Defense expressed concerns about the near-term costs and potential effects on local communities and Air Force readiness. In response to these concerns, the President, in forwarding the Commission's recommendations to Congress for approval, indicated that the air logistics centers' work should be privatized in place or in the local communities. He also directed the Secretary of Defense to retain 8,700 jobs at McClellan Air Force Base and 16,000 jobs at Kelly Air Force Base until 2001 to further mitigate the closures' impact on the local communities. Additionally, the size of the workforce remaining in the Sacramento and San Antonio areas through 2004 was expected to remain above 4,350 and 11,000, respectively.

McClellan has about 2,600 personnel and San Antonio has about 3,100 personnel assigned to organizations whose mission is to provide various base support services (such as security; maintenance of buildings, roads, and grounds; and medical clinic services) to the logistics center and all tenants. Depot maintenance employees comprise 66 percent of the Sacramento center personnel and 47 percent of the San Antonio center personnel. The centers' maintenance depots perform about $1.65 billion of depot maintenance work annually, about $400 million of which belongs to the other services and is done through interservicing. They also perform other logistics functions such as engineering support and weapon system and item management. Kelly Air Force Base had about 19,500 employees at the time of the 1995 BRAC process—of which 12,850 were air logistics center personnel, including 6,000 involved in depot maintenance. In addition to the air logistics center, Kelly has several other tenant activities, including the Air Intelligence Agency, Defense Information Systems Agency, Defense Distribution Depot, and guard and reserve units. McClellan Air Force Base employed about 14,000 people—of which 7,314 were center employees, including 4,853 depot maintenance personnel. In addition to the air logistics center, McClellan has a defense distribution depot, Coast Guard air station, and reserve units.

Statutes Influencing the Mix of Depot Maintenance Workloads Between the Public and Private Sectors

Several statutes influence the allocation of depot maintenance workloads between the public and private sectors. According to 10 U.S.C. 2464, a "core logistics capability" is to be identified by the Secretary of Defense and maintained by DOD, unless the Secretary waives DOD performance as not required for national defense. Further, 10 U.S.C. 2466 and 2469 limit the extent to which depot-level workloads can be converted to private sector performance. Section 2466 specifies that not more than 40 percent of the funds allocated in a fiscal year for depot-level maintenance or repair can be spent on private sector performance—the so-called "60/40" rule. Section 2469 prohibits DOD from transferring in-house maintenance and repair workloads valued at not less than $3 million to another DOD activity without using "merit-based selection procedures for competitions" among all DOD depots or to contractor performance without the use of "competitive procedures for competitions among private and public sector entities."

Privatizing-in-Place Is Not the Most Cost-Effective Approach Because Excess Capacity Still Exists

Privatizing defense depot activities in place could yield cost savings if other public and private activities were more fully utilizing their maintenance repair capacity. Because substantial excess capacity exists in both the public and private sectors, privatizing Sacramento and San Antonio workloads in place will result in missed opportunities to reduce the overall cost of Air Force depot maintenance operations.

Excess Capacity Is Costly

In recent years, depot maintenance rates have increased sharply. One of the major reasons for this increase is that as requirements have declined, the large fixed overhead costs for both the depots and the bases on which they are located must be allocated to a smaller depot maintenance workload base. As we noted previously, about 3,100 military and civilian personnel are involved in base support operations at Kelly Air Force Base and 2,600 at McClellan Air Force Base. These operations support center activities, including the depots, as well as other base tenant activities. It is estimated that a military depot with several thousand employees incurs fixed overhead costs of from $50 million to $100 million annually. By closing bases, DOD can eliminate base support and depot maintenance infrastructure and achieve substantial future savings. Additionally, consolidating workloads from closing depots with workloads of underused Air Force depots could yield additional savings at the receiving depots by increasing their efficiency, spreading their fixed overhead costs over a larger workload base, and lowering their average costs.

Privatizing-in-place does not substantially reduce infrastructure and excess capacity. It just moves some of it to the private sector. Private sector manufacturing and repair facilities also have extensive excess capacity. The privatization-in-place of the Sacramento and San Antonio depots will not reduce the large amount of excess capacity in the Air Force depot system and the private sector or their associated costs, unless additional facilities are closed or other cost-reduction means are successfully implemented.

Consolidating Workloads Could Produce Substantial Savings

The Air Force's planning has not progressed far enough to compare precisely the cost of privatizing depot workloads in place with the cost of transferring the work to other underused depots. However, because privatization-in-place will have little effect on excess capacity at the remaining depots, it is unlikely that any savings would offset the cost of maintaining excess depot capacity.

The Navy's experience closing naval aviation depots and consolidating workloads at remaining Navy facilities provides useful insights regarding the benefits of this closure option. According to Navy officials, consolidating workloads from three closing naval aviation depots and quickly moving most of this workload to the three remaining depots was projected to reduce excess capacity and decrease the overhead rates at remaining naval aviation depots. Capacity utilization was projected to increase 35 percent as a result of this consolidation. The utilization rate for each depot varies depending on the specific workload transfers and other variables, such as the rate of decline of their pre-consolidation workload base. Overall, the economy and efficiency improvements were projected to decrease the overhead rates by 18 percent between fiscal years 1994 and 1997. Based on a 10-million hour workload program, the consolidation could save an additional $100 million annually. Navy officials stated that because of the continuous decline in depot maintenance workloads and other factors, anticipated savings cannot be measured precisely. However, they noted that closing naval aviation depots and consolidating workloads in the Navy's remaining three depots has clearly improved efficiency and lowered the cost of the Navy depot maintenance program.

Our analysis of BRAC Commission estimates indicates that the closure of the depots at the San Antonio and Sacramento logistics centers were expected to save about $70 million annually. Based on our analysis of Air Force data, the actual savings could be as much as $206 million annually, if the closing depots' work is transferred to the remaining military depots. The Commission's estimate assumed that about 15 percent of the maintenance personnel at the closing centers could be eliminated. This evaluation did not attempt to measure economy and efficiency improvements that resulted from workload consolidation. However, our analysis indicates that transferring about 8.2 million hours of work from the closing Air Force depots to the three remaining depots[4] would (1) reduce these three depots' excess capacity from about 46 percent to about 8 percent, (2) lower the hourly rates by an average of $6.00 at receiving locations, and (3) save as much as $182 million annually as a result of economies of scale and other efficiencies.[5] This estimate was based on a workload redistribution plan that would only relocate 78 percent of the available hours to Air Force depots. This reallocation plan was developed by the Joint Depot Cross Service Group during the BRAC 1995 process. If our analysis had included a plan for redistributing all 10.5 million available hours of work, then our projected annual recurring savings would have been higher. Similarly, the Army estimates that the Commission-mandated transfer of about 1.2 million hours of ground communications workload from the Sacramento depot to the Tobyhanna Army Depot will save an additional $24 million.

According to financial management officials at the three remaining centers, it will cost about $475 million to absorb all of the 10.5 million direct labor hours of the Sacramento and San Antonio depot work currently available for reallocation. Comparing this cost estimate to our

[4]The Sacramento and San Antonio depots' projected workload for fiscal year 1999 is 10.5 million hours; however, to follow the workload allocation scheme developed for BRAC 1995 by the Joint Cross Service Group for Depot Maintenance, we assumed that 2.3 million hours of work, or about 21.9 percent of the total, would be transferred to Army and Navy depots.

[5]Because of numerous uncertainties, it is impossible to precisely estimate the potential savings. For example, we assumed that the C-5 workload would be moved from San Antonio to another depot, and was included in the estimated $110 million cost for establishing C-5 capability at another military depot, even though privatization—either in-place or at contractor facilities—would likely be the most cost-effective alternative.

$206 million projected annual savings indicates that net savings would occur within 2-1/2 years of the consolidation. Transition costs for moving only 78 percent of that workload would be less; therefore, net savings would occur in even less time if all of the 10.5 million direct labor hours available for redistribution to Air Force depots were moved. Moreover, $318 million of the projected $475 million are associated with the release or movement of depot maintenance personnel, and the costs are about the same for either option. DOD will incur these costs regardless of whether the workload is moved to other military depots or privatized-in-place. It could recoup the remaining $157 million in less than 1 year if the workloads were consolidated at other Air Force depots. Additionally, over $110 million of the remaining $157 million cost is required to support the movement of the C-5 aircraft workload. A decision to privatize the C-5 workload in place or at a contractor facility would reduce transition costs to between $50 million and $100 million, including the additional costs estimated to be required for the privatization. Thus, the cost of moving all but the C-5 is estimated to have a payback period of less than 8 months. Finally, the potential $200 million annual savings that could result from the consolidation is in addition to the BRAC Commission's $268-million savings estimate for eliminating base support operations and non-depot maintenance personnel at the McClellan and Kelly Air Force Bases.

On the other hand, if the remaining depots do not receive additional workload, they are likely to continue to operate with significant excess capacity and become more inefficient and expensive as workloads dwindle due to downsizing and privatization initiatives. If a depot is not closed, excess capacity and costs could still be reduced by downsizing-in-place and implementing various economy and efficiency initiatives. However, the amount of the reduction could be minimal without further workload consolidations and depot closures. Additionally, the remaining Air Force depots are located on large multi-functional bases that support other missions and optimum savings could not be achieved unless the entire base is closed.

Subsequent to our analysis, the Air Force Materiel Command analyzed potential savings from workload consolidation, including how increasing the efficiency of underused military depots would lower fixed overhead rates. This analysis showed that annual savings of $367 million can be achieved through consolidation of workloads in remaining DOD depots. Further, an additional $322 million could also be saved by relocating workload to depots that already have lower hourly rates. Based on the Air

Force analysis, payback of the projected $476 million workload relocation cost would occur in less than 1 year.

Privatization-in-Place Aggravates Excess Capacity Problem in the Private Sector

Excess capacity in the private sector is particularly acute for fixed-winged aircraft; communications, electronics, and avionics equipment; and engines. For example, in March 1996, we reported that private sector contractors indicate they have enough excess capacity to accomplish all of the projected depot workloads for six military engines: TF39, TF33, T63, F108/CFM56, 501K, and LM2500.[6] These contractors also said they have enough capacity to perform 75 percent of the military's T56 engine workload and 73 percent of its T700 engine workload.

According to industry representatives, the private sector has been reducing its excess capacity through mergers, closures, and consolidations, but DOD has not made comparable reductions in its infrastructure. A recent Defense Science Board study team concluded that privatization-in-place should be avoided, since it tends to preserve excess capacity. A privatization task force comprised of top executives from the aerospace industry that was formed by the governor of California in early 1996 concluded that privatization-in-place:

> "inhibits the realization of cost savings intended from base closures and the performance goal improvements that privatization is intended to achieve. Privatization-in-place, therefore, does not solve the excess capacity problem within either the public or the private sector of the defense industrial base."

According to industry representatives, this approach to downsizing will not achieve the intended objectives and is likely to be the most costly option of all.

Workload Redistribution Strategy Is Still Evolving

In August 1996, the Air Force announced its most recent strategy for allocating the depot workloads at Sacramento and San Antonio, but details are still evolving. The strategy indicates the workloads will be competed and that one of the remaining public depots will be allowed to compete with the private sector for each of the three large workload packages that are being developed. However, this strategy may limit public and private activities' ability to compete and favor privatizing the workloads in place.

[6] Depot Maintenance: Opportunities to Privatize Repair of Military Engines (GAO/NSIAD-96-33, Mar. 5, 1996).

Initial Acquisition Strategy

On August 16, 1996, the Air Force announced that it was revising its strategy for allocating the workloads at Sacramento and San Antonio. The Air Force's plans initially focused on privatizing five prototype workloads—three at Sacramento and two at San Antonio. The BRAC Commission report specified that the Defense Depot Maintenance Council should determine where depot maintenance workloads from the closing Air Force depots should be moved. The Council approved the Air Force's plan for the five prototype workloads on February 1, 1996. Table 2 shows the proposed prototype program, including the estimated annual value of the workloads and the number of workers involved.

Table 2: Privatization-in-Place Prototype Program Overview

Dollars in millions

Center	Workload	Annual value	Workers
Sacramento	Hydraulics	$ 43	328
Sacramento	Electric accessories	38	212
Sacramento	Software	30	343
San Antonio	C-5 paint/depaint	20	143
San Antonio	Fuel accessories	73	440
Total		**$204**	**1,466**

The prototype workloads involved about 11 percent of the San Antonio depot's maintenance personnel and about 27 percent of the Sacramento depot's personnel. Request for proposals were to be issued during the third quarter of fiscal year 1996 for the software and C-5 paint/depaint workloads and during the fourth quarter of fiscal year 1996 for the hydraulics, electrical accessories, and fuel accessories. Contract awards were projected for the first quarter of fiscal year 1997 for the hydraulics, software, C-5 paint/depaint, and fuel accessories workloads, and the second quarter of fiscal year 1997 for electronic accessories.

Shortly after the Defense Depot Maintenance Council approved the prototype program, DOD began to question the appropriateness of the concept. Community and industry groups expressed an interest in having larger packages, and DOD officials were concerned about the cost of administering a large number of smaller contracts. Additionally, a March 4, 1996, privatization task force created by the Governor of California concluded that:

> while privatization is desirable and will deliver more for the defense dollar, the more restrictive Privatization-in-Place is counterintuitive. The Department of Defense is expecting the private sector, which already carries significant excess capacity due to

defense downsizing, to be willing to take on workload to be performed at a closing base. Success is only possible if offerings are structured as viable business opportunities with ongoing potential and if the opportunities are strongly supported by the communities involved.[7]

Revised Acquisition Strategy

Implementation of the prototype concept was put on hold in May 1996 as the Air Force considered various options. Shortly thereafter, Air Force planners began to focus on a concept that would involve several large consolidated work packages, essentially one at Sacramento and two at San Antonio (one for the C-5 aircraft and one for engines). The Defense Depot Maintenance Council approved the revised acquisition strategy in August 1996. However, the 10 U.S.C. 2466 provision that limits private sector depot maintenance performance to no more than 40 percent—the 60/40 rule—constrains the Air Force's ability to privatize depot maintenance workloads. DOD has requested that Congress repeal this provision and other statutes affecting the allocation of depot maintenance workloads between the public and private sectors.

Air Force planners project that about $600 million of the two depots' $1.65 billion workload will be available to transfer to the private sector. If the 60/40 provision is not repealed in the future, the remaining $1.05 billion workload will be transferred to other military depots. This will substantially increase the use of these depots and reduce their labor hour rates for all workloads. If the 60/40 provision is repealed, DOD will need to eliminate substantial excess capacity at the military depots to reduce the cost impact of further privatization. In addition to the 60/40 provision, Air Force officials stated that they intend to comply with the 10 U.S.C. 2469 provision requiring public/private competitions before transferring depot-level workloads valued at not less than $3 million to the private sector.

Under the revised strategy, one request for proposals will be issued for all Sacramento workloads that are proposed to be privatized-in-place, including A-10 and KC-135 aircraft, hydraulics, instruments and electronic accessories, and software. Air Force planners estimated the value of the Sacramento workload to be about $220 million annually, with a projected 2,200 workers involved. According to Air Force officials, the Sacramento work package can be privatized without breaching the 60/40 provision. The Air Force is following a three-phased approach for competing the Sacramento workload. The first phase began on November 8, 1996, with

[7]Pathway to Privatization—An Industry Perspective, Report of the California Chief Executive Officers' Defense Privatization Task Force to Governor Pete Wilson (Mar. 4, 1996).

the issuance of a request for proposals for a study to analyze the Sacramento depot workload, explore approaches for process improvement, and make recommendations for the maintenance contract solicitation. The Air Force anticipates awarding study contracts to one or two offerors for about $750,000 in January 1997. The second phase, the contract study, is scheduled to run until September 1997, although the Air Force plans to issue a request for proposals for the maintenance contract in July 1997. The final phase, the award of the maintenance contract, is expected in January 1998.

A two-pronged acquisition strategy has been proposed for San Antonio. One request for proposals is for the C-5 aircraft business area, which has an annual value of $155 million and involves about 1,200 workers. The Air Force issued a draft request for proposals for the C-5 workload in November 1996. The strategy for San Antonio's engine business area is uncertain, largely because of the 60/40 provision. According to Air Force officials, since the 60/40 provision has not been repealed, only a portion of the $700 million San Antonio engine workload can be privatized along with the other proposed packages. Air Force planners estimated that about $240 million of San Antonio's engine workload could be privatized without breaching the 60/40 threshold. This limitation would likely allow privatization of only one, or portions of all three, of San Antonio's three large engine workloads.

Because of the 60/40 provision, preliminary Air Force plans provide for some workloads to be transferred to the three remaining Air Force depots. These transfers would include electrical components, automatic test equipment hardware, F-15 workload and gas turbine engines, and engine workloads over the 60/40 limitation. San Antonio and Sacramento local manufacturing workloads would also be transferred to one of the three remaining Air Force depots in 2001. Personnel associated with the weapon system and item management functions at the closing centers are also scheduled to be transferred in 2001 to one of the three remaining air logistics centers or to one of the Air Force product centers that manage the acquisition of Air Force systems and equipment. Further, the Air Force microelectronics facility located at the Sacramento depot will transfer to the Defense Logistics Agency. This approximately 140-person operation will continue to function in its current location, with the Defense Logistics Agency likely to assume ownership of the depot plant equipment and lease the building from the local reuse authority.

Strategy May Limit Public and Private Competition and Favors Privatizing-in-Place

The Air Force's revised strategy of competing large consolidated workloads may limit competition from military depots. According to Air Force officials, the solicitation requires that all the work be performed at a single location, does not allow military depots to jointly compete for the work, and only allows one depot to compete for each of the three large workload packages. The competing Air Force depot will not be allowed to subcontract work to a private contractor or to propose maintaining any of the workloads in place. Since no single military depot can currently perform all the work for two of the consolidated packages, the ability of the military depots to compete may be limited. The single location requirement also prohibits contractors from moving individual workloads to multiple underused private sector facilities. Also, the plan to privatize the Defense Logistics Agency supply depots at the Sacramento and San Antonio locations provides an incentive to perform the work at the same location.

Core Capability Requirements May Affect Privatization Plans

According to 10 U.S.C 2464, DOD activities must maintain a core logistics capability, including personnel, equipment, and facilities sufficient to provide the technical competence and resources necessary for effective and timely response to a mobilization or other national defense emergency. DOD facilities are to retain core capability unless the Secretary waives DOD performance as not being required for national defense. Air Force data developed and certified during the 1995 BRAC process indicated that about 77 percent of Sacramento's and 70 percent of San Antonio's projected fiscal year 1996 depot maintenance workload represented core capability. As a result, the Air Force cannot fully implement privatization-in-place plans for Sacramento and San Antonio without executing a waiver and reporting to Congress.

In April 1996, DOD provided Congress a depot maintenance policy report that included a new process for evaluating core. The report said that the military services would conduct a risk assessment before privatizing mission-essential workloads, which previously would have been identified as core.[8] As we reported on May 21, 1996, DOD's policy report described a model for making these assessments, but did not provide criteria for evaluating private sector capabilities, establishing risk thresholds, and making best value determinations.[9] Additionally, we noted that (1) such

[8]Report on Policy Regarding Performance of Depot-Level Maintenance and Repair, Department of Defense (Apr. 4, 1996).

[9]Defense Depot Maintenance: DOD's Policy Report Leaves Future Role of Depot System Uncertain (GAO/NSIAD-96-165, May 21, 1996).

criteria is critical to both implementing the model and determining whether mission-essential workloads previously determined to be core capability and performed in military depots can be outsourced at acceptable levels of risk and (2) until this guidance and criteria are established and implemented, the core requirements that will result from the new policy cannot be predicted with any precision. Also, DOD has not yet developed a standardized process for assessing core capability, including a documented risk assessment that evaluates private sector repair capability. As a result, each military service was independently planning and developing its own risk assessment process.

While the Air Force is developing a process for reassessing core requirements, evaluations of the Sacramento and San Antonio depot maintenance workloads proposed for privatization have not yet been completed. It is uncertain to what extent the Air Force will determine that mission-essential workloads previously defined as core should be privatized. However, the Air Force has issued draft request for proposals involving workloads previously identified as core without obtaining waivers or redefining the workload as noncore.

Delaying Closure and Realignment Will Be Costly

To reduce the closures' effect on the Sacramento and San Antonio communities, DOD plans to delay closing McClellan Air Force Base and parts of the Kelly Air Force Base until 2001, thereby retaining 8,700 jobs at McClellan and 16,000 jobs at Kelly. This delay will eliminate much of the $973.8 million savings estimated by the BRAC Commission to result from reduced personnel and operating costs beginning in 1997. These savings were to offset one-time closure costs of $822.6 million.

BRAC Commission Cost and Savings Estimates

As shown in table 3, the BRAC Commission projected a net savings of $151.2 million during the 6-year implementation period after projected implementation costs of $822.6 million are deducted from the projected total savings. The savings were to be achieved by reducing personnel requirements and operating costs. However, these savings were expected to be partially offset by one-time implementation costs for such things as the transfer of personnel and equipment to new sources of repair.

Table 3: BRAC Commission's Cost and Savings Estimates for Mcclellan and Kelly Air Force Bases

Dollars in millions

	Fiscal year						
	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**Total**
Total savings	0	$36.1	$112.1	$199.3	$286.1	$340.3	**$973.8**
Implementation costs	$8.8	202.9	225.3	184.3	201.2		**822.6**
Net savings/(costs)	($8.8)	($166.9)	($113.2)	$15.0	$84.8	$340.3	**$151.2**

Note: Costs and savings were calculated in fiscal year 1996 dollars. Totals may not add due to rounding.

Implementation Delays Would Reduce Savings

The cost impact of the decision to delay the closures depends on how long they are delayed. For example, a 1-year delay would reduce the BRAC Commission's projected savings by about $90 million, whereas a 4-year delay would reduce savings by about $796 million.[10]

The BRAC Commission expected $845.6 million, or 86.8 percent, of the $973.8 million implementation period savings to be achieved through personnel reductions. It expected that closing the Sacramento and San Antonio centers would eliminate 6,316 military and civilian positions. The personnel reductions were to start in fiscal year 1997 and be completed by the end of fiscal year 2000.

The financial benefit of eliminating positions as early as possible becomes readily apparent when the impact is tracked into subsequent years. For example, the BRAC Commission projected that 1,378 positions would be eliminated in fiscal year 1997, which would save $31.8 million during the first year and $63.5 million every year thereafter.[11] Eliminating these positions was expected to save $285.8 million during the implementation period. Table 4 shows how the estimated savings will be affected.

[10]A 4-year delay costs significantly more per year than a 1-year delay because it pushes back the time period when savings will exceed costs (as shown in table 4). These are one-time costs for extending operations at the centers.

[11]The Commission assumed that the position eliminations would be spread evenly throughout the year and that first-year savings would, therefore, be half the annual recurring savings.

Table 4: Impact on Savings Caused by Delaying the Elimination of 1,378 Positions

Dollars in millions

Fiscal year of personnel reduction	Savings achieved during fiscal year					Total savings	Change in savings
	1997	1998	1999	2000	2001		
1997	$31.8	$63.5	$63.5	$63.5	$63.5	**$285.8**	0
1998		31.8	63.5	63.5	63.5	**222.3**	($63.5)
1999			31.8	63.5	63.5	**158.8**	(127.0)
2000				31.8	63.5	**95.3**	(190.6)
2001					31.8	**31.8**	(254.1)

Note: Savings were calculated in fiscal year 1996 dollars. Totals may not add due to rounding.

Table 5 shows the impact that implementation delays will have on the Commission's net savings estimates, assuming that all costs and savings remain the same and are simply delayed.

Table 5: Impact of Closure Delays on Net Savings or Costs for Fiscal Years 1996 to 2001

Dollars in millions

Length of delay	Net savings (costs)	Change in savings
No delay (savings start in 1997)	$151.2	0
1-year delay (savings start in 1998)	60.6	($90.6)
2-year delay (savings start in 1999)	(93.2)	(244.5)
3-year delay (savings start in 2000)	(333.7)	(484.9)
4-year delay (savings start in 2001)	(644.4)	(795.6)

Note: Costs and savings were calculated in fiscal year 1996 dollars. Totals may not add due to rounding.

Transfer of Workloads to Tobyhanna Army Depot Delayed Until 2001

The BRAC Commission's recommendation to transfer common-use ground communication-electronics workload from the Sacramento depot—about 1.2 million direct labor hours of work—to the Tobyhanna Army Depot would increase Tobyhanna's capacity utilization from 49 percent to 65 percent, reduce Tobyhanna's hourly labor rate by $6 (from $64 to $58), and save about $24 million annually. This workload includes repairing and overhauling such items as radar, radio communications, electronic warfare, navigational aids, electro-optic and night-vision devices, satellite sensors, and cryptographic security equipment.

The Air Force, with the approval of the Defense Depot Maintenance Council, is delaying the transfer of this workload to Tobyhanna until 2001 to support personnel retention goals in the Sacramento area. As we recently reported, this delay will decrease savings and result in interim personnel reductions at Tobyhanna.[12] According to Army officials, delaying all of the workload transfers to Tobyhanna until 2001 could require the depot to undergo a reduction-in-force, followed by a costly rehiring and retraining situation when it does eventually receive the Air Force workloads. Because its workload has been declining, Tobyhanna has already voluntarily separated about 250 of its personnel during 1996. Army officials said that about 800 personnel may be involuntarily separated in fiscal years 1997 or 1998 if no additional workloads are transferred to Tobyhanna. This reduction would include the loss of personnel having critical skills and competencies needed to work on the ground communications workload.

Statutes Affect Efforts to Privatize Workloads

As we previously reported, various statutory restrictions may affect how much of the depot-level workloads can be transferred to the private sector—through privatization-in-place or otherwise. They include 10 U.S.C. 2464, 10 U.S.C. 2466, and 10 U.S.C. 2469. While each of these statutes has some affect on the allocation of DOD's depot-level workload, 10 U.S.C. 2469 constitutes the primary impediment to privatization in the absence of a public-private competition.

Competition requirements of 10 U.S.C. 2469 have broad application to all changes to the depot-level workload valued at not less than $3 million that is currently performed at DOD installations, which include Kelly and McClellan. They require DOD to give other public depots the opportunity to compete for the closing depots' workloads. The statute does not provide any exemptions from its competition requirements and, unlike most of the other laws governing depot maintenance, does not contain a waiver provision. Further, there is nothing in the Defense Base Closure and Realignment Act of 1990—the authority for the BRAC recommendations—that, in our view, would permit the implementation of a recommendation involving privatization outside of the competition requirements of 10 U.S.C. 2469.

The determination of whether any single conversion to private sector performance conforms to the requirements of 10 U.S.C. 2469 depends upon the facts applicable to the particular conversion. While DOD has stated that it will structure these conversions to comply with existing

[12] Army Depot Maintenance: Privatization Without Further Downsizing Increases Costly Excess Capacity (GAO/NSIAD-96-201, Sept. 18, 1996).

statutory restrictions, details of its privatization plans for Kelly and McClellan are still evolving. Sufficient information regarding the detailed procedures for conducting the competitions for the Sacramento and San Antonio workloads is not available for us to assess whether the planned conversions will comply with the requirements of existing law. Further, the planned privatizations at Sacramento and San Antonio are now the subject of litigation. In March 1996, the American Federation of Government Employees filed a lawsuit challenging these privatization initiatives, contending that they violate the public-private competition requirements of 10 U.S.C. 2469 and other depot maintenance statutes.[13]

Recommendations

We recommend that the Secretary of Defense require the Secretary of the Air Force to take the following actions:

- Develop required capability in military depots to sustain core depot repair and maintenance capability for Air Force systems and conduct and adequately document a risk assessment for mission-essential workloads being considered for privatization at the San Antonio and Sacramento depots.
- Before privatizing any Sacramento or San Antonio workload, complete a cost analysis that considers the savings potential of consolidating the San Antonio and Sacramento depot maintenance workloads at other DOD depots, including savings that can be achieved for existing workloads by reducing overhead rates through more efficient capacity utilization of fixed overhead at underused military depots that could receive this workload.
- Use competitive procedures, where applicable, for determining the most cost-effective source of repair for workloads at the closing Air Force depots.
- Reconsider plans to delay (1) the transfer of the ground communications and electronics workload from the Sacramento Depot to Tobyhanna and (2) other delays in transferring workload to the public or private sector that are reducing savings estimated by the BRAC Commission to be achieved from closure and consolidation.

Agency Comments and Our Evaluation

DOD provided oral comments on our draft report. It concurred with each of our recommendations and made several technical comments that have been incorporated where appropriate. DOD also noted several actions it is taking to respond to our recommendations. Specifically:

[13] American Federation of Government Employees v. Clinton, No. C2 (96-0283 (S.D. Ohio 1996)).

- DOD and the Secretary of the Air Force will develop the required capability in military depots to sustain core depot repair and maintenance capabilities for Air Force systems. Furthermore, the Air Force is in the process of conducting and documenting a risk assessment of the capability for those workloads being considered for public-private competition at the San Antonio and Sacramento depots.
- DOD agreed to consider potential savings from consolidating the San Antonio and Sacramento depot maintenance workloads at other DOD depots as a part of its planned evaluation of the public-private competitions for these workloads.
- DOD plans to use public-private competitions for determining the most cost-effective source of repair for depot workloads at Sacramento and San Antonio.
- DOD and the Air Force are working closely to finalize plans for transferring the ground and electronics workload from the Sacramento Depot to Tobyhanna. DOD's response did not address its position regarding delays in transferring other Sacramento and San Antonio workloads not expected to be included in the public-private competitions. Air Force officials stated that they are considering various options for these workloads that include both private and public sector sources.

Scope and Methodology

We obtained information from and interviewed officials at the Office of the Secretary of Defense; Air Force Headquarters, Washington, D.C.; Air Force Materiel Command Headquarters, Wright-Paterson Air Force Base, Ohio; the Sacramento Air Logistics Center, McClellan Air Force Base, California; the San Antonio Air Logistics Center, Kelly Air Force Base, Texas; the Warner Robins Air Logistics Center, Robins Air Force Base, Georgia; the Ogden Air Logistics Center, Hill Air Force Base, Utah; the Oklahoma City Air Logistics Center, Tinker Air Force Base, Oklahoma; the Aerospace Guidance and Metrology Center and Defense Contract Management Office, Newark Air Force Base, Ohio; the Joint Depot Maintenance Analysis Group, Gentile Station, Dayton, Ohio; the Army Industrial Operations Command, Rock Island, Illinois; the Naval Air Systems Command, Washington, D.C.; and the Naval Aviation Depot Operations Center, Naval Air Station, Patuxent River, Maryland. We also discussed privatization-in-place issues with Sacramento and San Antonio community leaders and the Defense Contract Audit Agency. This work was part of a broad-based review of depot maintenance requirements, capability, and workload distribution issues. A list of related products is provided at the end of this report.

To evaluate DOD's rationale for (1) delaying the closure of McClellan Air Force Base and the realignment of Kelly Air Force Base and (2) privatizing the Sacramento and San Antonio air logistics centers' depot maintenance workloads, we reviewed various documents, including the Secretary of Defense's July 13, 1995, letter to the President and a July 13, 1995, White House press release. We then discussed this rationale with DOD, Air Force Material Command, and air logistics center officials.

Because Air Force officials have not yet determined how or when privatization-in-place will be implemented at the two closing depots, neither we nor the Air Force can develop precise costs and savings estimates. As a result, we (1) reviewed the BRAC Commission's cost and savings estimates and (2) estimated the "economy of scale" savings that could be achieved by using the closing depots' workloads to reduce excess capacity in the remaining depots.

To estimate the potential from transferring the closing depots' workloads to the remaining depots, we allocated 8.2 million hours of work, or about 78 percent of the projected fiscal year 1999 workload, to the three remaining centers. We used a scheme developed for BRAC 1995 by the Joint Cross Service Group for Depot Maintenance, but modified it slightly. Based on input from Air Force Materiel Command and Center officials, we assumed that the C-5 workload would be transferred to the Warner Robins Air Logistics Center rather than the Oklahoma City Air Logistics Center. We provided each center with a breakout of the transferring workload they would receive by commodity group. We then asked center personnel to estimate how additional workloads would affect their hourly rates by analyzing fixed- and variable-cost categories, excluding material, which we assumed would not change. The three centers used the approach and assumptions developed by executive business planners from all five centers to develop the downsize-in-place Air Force proposal developed during the 1995 BRAC round as an alternative to closing depots.

We discussed the methodology with workload and privatization officials at the Air Force Materiel Command. They agreed that our approach was sound for assessing the impact of additional workload on a depot's rate structure. We also provided the closing centers with an opportunity to comment on our methodology. San Antonio center officials agreed with the general approach, but commented that increases in variable costs were subjective. Sacramento center officials chose not to comment.

To determine whether Air Force plans for privatizing the closing depots is consistent with (1) laws relating to the allocation of depot maintenance workloads to the private sector and (2) the BRAC Commission's recommendations, we identified the applicable requirements and determined their impact on DOD's plans to privatize depot-level maintenance workloads.

We conducted our review between October 1995 and October 1996 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretary of Defense; the Secretary of the Air Force; the Director, Office of Management and Budget; and interested congressional committees. Copies will be made available to others upon request. If you have any questions, please contact me at (202) 512-8412. Major contributors to this report are listed in appendix I.

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Related GAO Products

Army Depot Maintenance: Privatization Without Further Downsizing Increases Costly Excess Capacity (GAO/NSIAD-96-201, Sept. 18, 1996).

Navy Depot Maintenance: Cost and Savings Issues Related to Privatizing-in-Place the Louisville, Kentucky Depot (GAO/NSIAD-96-202, Sept. 18, 1996).

Defense Depot Maintenance: Commission on Roles and Mission's Privatization Assumptions Are Questionable (GAO/NSIAD-96-161, July 15, 1996).

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