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Government Sees High Returns On Defaulted Student Loans

By MELISSA KORN

Defaulting on federal student loans may not be such a bad thing--at least, not for the federal government.

After paying the companies that actually collect the loans and other costs, the U.S. Department of Education expects to recover 85% of defaulted federal loan dollars based on current value. The recovery figures are quite generous when compared with other corners of consumer debt. Banks, for example, often retrieve less than 10 cents on the dollar from overdue credit cards.

According to White House budget figures for fiscal 2011 ending in September, the federal government expects gross recovery of between $1.10 and $1.22 for every dollar of defaulted student loans. An estimated $49.9 billion of Federal Family Education Loan and Federal Direct Lending Program loans are in default, out of a total $713.4 billion outstanding, as of Sept. 30. Those amounts include only principal balances, not interest.

While students may default on their loans, it is nearly impossible to discharge student loan debt, even in bankruptcy. The government can garnish a borrower's wages, withhold tax returns and siphon off Social Security and disability payments in order to recover the funds. Collection costs stretch out the defaulted loan's term, with those payments taking precedence over principal reduction. That, in turn, allows the government to tack on extra interest.

The strong loan return rates may prove awkward for the federal government, which is instituting regulations on for-profit colleges. The government is arguing the schools' graduates cost taxpayers too much money because they learn little in class and ultimately default on loans at high rates. According to the Education Department, 46% of dollars lent to for-profit college students will ultimately default, compared with an average of 16% across all schools.

Students are "left with the debt and questionable job prospects, and it's financed with taxpayer dollars," Education Department spokesman Justin Hamilton said.

The Senate Committee on Health, Education, Labor and Pensions is conducting hearings to evaluate the educational value of the for-profit colleges, but, given the high recovery rates on defaulted loans, it isn't clear how much protection taxpayers need. "Even at 85%, the government's not losing all that much money," said Mark

Kantrowitz, publisher of financial aid website FinAid.org.

Still, Sen. Tom Harkin (D., Iowa), chairman of the Senate HELP Committee, said it's not enough that the government recoups most of its money. "Default should not be considered success, for either taxpayers or students who end up in debt."

According to Kantrowitz, the government stands to earn $2,010.44 more in interest from a $10,000 loan that

defaulted than if it had been paid in full over a 20-year term, and $6,522.00 more than if it had been paid back in 10 years. Alan Collinge, founder of borrowers' rights advocacy Student Loan Justice, said the high recovery rates provide a "perverted incentive" for the government to allow loans to go into default. Kantrowitz estimates the recovery rate would need to fall to below 50% in order for default prevention efforts to become more lucrative than defaults themselves.

Hamilton said default prevention is "baked into" the Federal Direct Loan Program, under which all new federal student loans are originated. "Servicers who do a good job keeping defaults down will get more business. Those who can't, won't."

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