

DEAR BARON REAL ESTATE FUND SHAREHOLDER:

Whew! What a year! 2011 began with an upswing for stocks, due to general optimism that the global economy was mending. It was soon followed, however, with a barrage of shocks and headlines from Europe, Asia, the Mideast and the U.S., all contributing to dramatic volatility in the stock market, overshadowing the generally strong profit reports of many U.S. companies. Specifically, for much of 2011, investors were fixated on geopolitical strife in the oil-producing Mideast; Japan's earthquake, tsunami and nuclear crisis; the debt crisis in Europe; and the legislative gridlock in Washington leading to Standard & Poor's downgrade of the U.S. credit rating. The result? The S&P 500 Index for the full year ending 2011 was virtually flat on a price-only basis (up 2.11%, including dividends)!

PERFORMANCE

Table I.
Performance (Retail Shares)[†]
Annualized for periods ended December 31, 2011

	Baron Real Estate Fund ^{1,2}	MSCI USA IMI Extended Real Estate Index Net ¹	S&P 500 Index ¹
Three Months ³	17.08%	15.86%	11.82%
One Year	0.63%	-2.26%	2.11%
Since Inception (December 31, 2009)	12.87%	10.45%	8.39%

Performance listed in the above table is net of annual operating expenses. As of the last fiscal year ended December 31, 2010, annual operating expense ratio for the Retail Shares was 4.35%, but the net annual expense ratio was 1.35% (net of the Adviser's fee waivers). *The performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost. The Adviser has reimbursed certain Fund expenses and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON.*

[†] If the Fund's historical performance was impacted by gains from IPOs and/or secondary offerings, there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs and secondary offerings will be the same in the future.

¹ The MSCI USA IMI Extended Real Estate Index Net and the S&P 500 Index are unmanaged. The MSCI USA IMI Extended Real Estate Index Net is a custom index calculated by MSCI for, and as requested by, BAMCO, Inc. The index includes real estate and real estate-related GICS classification securities. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, reviewed or produced by MSCI. The S&P 500 measures the performance of large cap U.S. equities in the stock market in general. The indexes and the Fund include reinvestment of interest, capital gains and dividends, which positively impact the performance results.

² The performance data in the table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.

³ Not annualized.



JEFFREY KOLITCH
PORTFOLIO MANAGER

Yet, the strong fourth quarter of 2011 was hopefully a harbinger of better times. Following a poor third quarter ending September 30, 2011, one of the worst quarterly performances in recent years when the S&P 500 Index declined 13.87%, the U.S. market quickly snapped back in the quarter ended December 31, 2011 gaining 11.82%. Wider recognition of generally positive economic data and strong reported business performance were among the catalysts that finally drove most share prices higher.

We are pleased with the 2011 performance of the Baron Real Estate Fund ("BREAL" or the "Fund") relative to the general overall real estate-related market. The Fund gained 0.63%, outpacing its primary benchmark, the MSCI USA IMI Extended Real Estate Index Net (the "MSCI Real Estate Index"), which declined 2.26%. The S&P 500 Index gained 2.11% in 2011. In the fourth quarter ended December 31, 2011, the Fund generated a 17.08% return that also compares favorably to the MSCI Real Estate Index gain of 15.86% and the S&P 500 Index gain of 11.82%.

The Fund has now been open for two years. We are pleased that since its inception on December 31, 2009, the Fund has outperformed both the MSCI Real Estate Index and the S&P 500 Index. In its two years of performance, BREAL has generated a 12.87% annual return, outpacing the MSCI Real Estate Index which gained 10.45% and the S&P 500 Index which gained 8.39%.

We are optimistic about the prospects for the Baron Real Estate Fund in 2012. For our perspective on the market, real estate-related securities, and the Fund, please see the "Outlook" section later in this letter.

Baron Real Estate Fund

Table II.
Top contributors to performance for the quarter ended December 31, 2011

	Quarter End Market Cap (billions)	Percent Impact
Wyndham Worldwide Corp.	\$5.8	1.69%
Capital Senior Living Corp.	0.2	1.26
Targa Resources Corp.	1.7	1.01
Brookdale Senior Living, Inc.	2.1	0.96
Tesoro Logistics LP	1.0	0.85

In the fourth quarter of 2011, strength in corporate earnings and signs of recovery in the U.S. economy helped to propel the market higher. Not surprisingly, those companies that tend to benefit most from the early stages of an economic rebound outperformed during this period.

Hotel and leisure companies such as **Wyndham Worldwide Corp.**, **Starwood Hotels & Resorts Worldwide, Inc.**, and **LaSalle Hotel Properties** increased sharply as business and leisure travel remained robust.

Despite the strong performance of hotel stocks in the most recent quarter, we believe these stocks will continue to perform well in 2012. For the full year 2011, Wyndham Worldwide Corp. increased 28.7%, while most hotel stocks generated negative returns despite strong occupancy and room rate growth. At this time, valuations are increasingly attractive. Hotel occupancies are near peak levels and growing at a time when only modest new hotel construction is forecasted. As a result, we expect hotel demand to continue to outstrip supply that should lead to strong cash flow growth. If the economy continues to rebound, we believe these stocks will perform well in 2012.

The shares of senior housing operators, **Capital Senior Living Corp.** and **Brookdale Senior Living, Inc.**, also were among the top contributors to performance in the fourth quarter. In our opinion, these housing-related stocks were overly penalized in the summer of 2011 when concerns of a dramatic economic slowdown spiked. We believe valuations for senior housing operators remain among the most attractive in the real estate category. These stocks should continue to benefit from a modestly improving economy and housing market.

Master limited partnerships ("MLPs"), such as **Targa Resources Corp.** and **Tesoro Logistics LP**, with 4-5 percent dividend yields and strong growth profiles, were among the Fund's best performers in the fourth quarter of 2011, and for the entire year.

Table III.
Top detractors from performance for the quarter ended December 31, 2011

	Quarter End Market Cap or Market Cap When Sold (billions)	Percent Impact
Zillow, Inc.	\$ 0.6	-0.34%
Molycorp, Inc.	2.4	-0.16
FirstService Corp.	0.7	-0.05
Corporate Office Properties Trust	1.5	-0.04
Brookfield Asset Management, Inc.	17.2	-0.03

Following a spike in its share price shortly after its IPO, the shares of **Zillow, Inc.**, the leading web site for residential real estate, corrected sharply, and has now returned to a more reasonable level, in our opinion. We believe the

company's growth opportunities remain significant. It is forecasted that billions of dollars will continue to be spent annually on U.S. real estate-related advertising, and we believe Zillow is best positioned to benefit from the move to on-line real estate advertising and information.

Molycorp, Inc. fell sharply in the fourth quarter as rare earth prices dropped. Given the more uncertain outlook for rare earth demand and prices, we have chosen to exit our position in the company. Real estate services firm **FirstService Corp.** also lagged in the most recent quarter, as concerns surfaced about a slowdown in commercial real estate leasing and purchase and sale activity. Though we believe the concerns are overblown, we sold our shares and reallocated the capital to other real estate services companies, such as **CBRE Group, Inc.**, that we believe offer more attractive return potential in 2012. **Corporate Office Properties Trust**, a REIT, is a developer and landlord of specialized office space for the U.S. government, government contractors, and defense information technology tenants. It is also a landlord of more traditional suburban office buildings. The shares performed poorly in 2011 due to expected defense budget cuts, disappointing business performance, and sub-par business prospects for the company's suburban office building portfolio. The Fund has exited its investment in the company.

PORTFOLIO STRUCTURE

During the summer's market swoon, the Fund took advantage of the sharp correction in most stock prices to buy securities that in our opinion had previously been too expensive. We also added to companies in which we have the highest conviction, and increased the Fund's allocation in certain real estate categories. In the fourth quarter, however, BREAL bought or sold relatively few securities, and the Fund's allocations to various real estate categories were only modestly changed.

In prior letters, we have expressed our view that a balanced, broad, and diversified approach to real estate-related investing is advisable. We maintain this opinion, and the Baron Real Estate Fund has been structured accordingly. The Fund combines a dividend yield component with more traditional real estate-related growth stocks.

Table IV.
Fund's investments in real estate categories as of December 31, 2011

	Percent of Net Assets
REITs	25.3%
Hotel & Leisure ¹	15.2
Infrastructure-Related & MLPs	13.4
Real Estate Service Companies	12.9
Senior Housing Operators	9.7
Towers	6.3
Data Centers ²	5.1
Casinos & Gaming	4.8
Building Products/Services	3.6
Real Estate Operating Companies	2.8
Cash and Cash Equivalents	0.9
	100.0%

¹ Total would be 18.1% if included hotel REIT LaSalle Hotel

² Total would be 7.3% if included data center REIT Digital Realty Trust

The income or dividend yield component of BREAL is approximately 39%, with REITs comprising 25.3%, and infrastructure-related and MLPs 13.4%.

Approximately 61% of the Fund is invested in real estate-related companies that tend to have more open-ended growth opportunities such as hotels, real estate service companies, senior housing operators, and tower companies.

We believe the proportion of approximately 39% dividend-focused securities and 61% traditional growth securities is appropriate for the current environment. High dividend-yielding securities such as REITs and MLPs should continue to have appeal in the currently low interest rate environment (versus the 10-year Treasury of approximately 2%). Growth-oriented real estate securities, many which have attractive valuations, may generate better returns than many dividend-yielding securities if economic activity improves.

At December 31, 2011, the Fund maintained 39 positions. Our 10 largest holdings equaled 37.5% of the Fund with an average position size of 3.75%, and our 20 largest holdings equaled 64.9% of the Fund with an average position size of 3.25%.

RECENT ACTIVITY

Table V.
Top net purchases for the quarter ended December 31, 2011

	Quarter End Market Cap (billions)	Amount (thousands)
Rose Rock Midstream, L.P.	\$ 0.3	\$431.7
Education Realty Trust, Inc.	0.9	228.4
MICROS Systems, Inc.	3.7	93.8
Hyatt Hotels Corp.	6.2	68.8
Stanley Black & Decker, Inc.	11.4	67.4
Carnival Corp.	26.5	66.4
Brookfield Asset Management, Inc.	17.2	62.0
Sunrise Senior Living, Inc.	0.4	56.3
Penn National Gaming, Inc.	3.0	55.2
Brookdale Senior Living, Inc.	2.1	54.3

MLPs with attractive dividends and strong growth profiles (**Golar LNG Partners L.P.**, **Targa Resources Corp.**, **Tesoro Logistics LP**) have been positive contributors to the Fund. In the most recent quarter, the Fund increased its allocation to MLPs with the purchase of **Rose Rock Midstream, L.P.** ("Rose Rock"). Rose Rock was recently spun off from SemGroup Corp. ("SEMG"). The company provides gathering, transportation, storage, distribution, marketing, and other services to producers, refiners of petroleum products and other market participants.

SEMG, which is the General Partner and holds 57% of the common units, has a vested interest in driving growth through a portfolio of possible sales to Rose Rock. SEMG is planning to sell or "drop down" high quality assets (over 75% fee/fixed margin-based, long-term contracts) to Rose Rock. Rose Rock has zero debt, and we believe the company may double cash flows in the next two years. Combined with opportunities to enhance the existing portfolio through highly profitable capital investment projects, we believe Rose Rock should be able to generate strong dividend growth over the next several years from its currently attractive 7.25% dividend.

We are enthusiastic about the long-term prospects for certain student housing developers and landlords. Many universities, constrained by tight budgets, are seeking private sector assistance to develop and operate student housing residences. We believe we are in the early stages of this outsourcing trend. Student housing REITs, **American Campus Communities, Inc.** (2.5% of BREAL

at December 31, 2011) and **Education Realty Trust, Inc.** ("EDR", 1.6% of BREAL at December 31, 2011), are poised to benefit from what we believe will be a long-term secular growth opportunity.

We acquired shares in EDR in the most recent quarter. The company has many long-term growth opportunities. Last month, the University of Kentucky announced its plans to outsource 100% of its student housing to EDR. In our opinion, this mandate could ultimately generate \$35 million of incremental cash flow to EDR's current annual cash flow run-rate of approximately \$57 million. Additional outsourcing mandates from universities are possible in the future. Excluding the University of Kentucky opportunity, the company's current development pipeline would expand its operating portfolio by approximately 14 percent. Further, we believe the company should benefit in 2012 from increases in occupancy and rental rates in its current operating portfolio.

Following a recent visit to its corporate headquarters, we increased our investment in **MICROS Systems**. The company is the largest provider of technology systems to hotels. It also provides services to many restaurants and retailers. The company has zero debt and a large cash position that could be utilized for acquisitions, stock repurchases, or dividends. We believe MICROS Systems has several opportunities for growth and the shares are attractively valued.

Table VI.
Top net sales for the quarter ended December 31, 2011

	Quarter End Market Cap or Market Cap When Sold (billions)	Amount (thousands)
FirstService Corp.	\$ 0.7	\$-172.6
Molycorp, Inc.	2.4	-169.4
Tesoro Logistics LP	1.0	-160.6
Corporate Office Properties Trust	1.5	-139.5
Targa Resources Corp.	1.7	-137.3
CubeSmart	0.8	-132.2
HFF, Inc.	0.3	-85.0
Zillow, Inc.	0.6	-35.2
Vornado Realty Trust	14.2	-23.6
SBA Communications Corp.	4.7	-22.4

In the most recent quarter, we exited our positions in real estate services firms **FirstService Corp.** and **HFF, Inc.** and sold a portion of **Zillow, Inc.** We reallocated this capital to other real estate services companies, such as **CBRE Group, Inc.** and **MICROS Systems**, that we believe offer attractive return potential in 2012. We also exited **Molycorp, Inc.** due to a drop in rare earth prices and a less certain demand profile. Following very strong performance, we decreased our position in two MLPs, **Tesoro Logistics LP** and **Targa Resources Corp.** We exited **Corporate Office Properties Trust**, a REIT that specializes in developing, acquiring, and leasing defense-related office buildings. Defense budget cuts and sub-par business prospects for the company's suburban office building portfolio may continue to weigh on the shares.

OUTLOOK

We are mindful that there are a number of economic and political uncertainties, both foreign and domestic, that may continue to weigh on the market.

Baron Real Estate Fund

At Baron, we are hopeful that favorable cyclical tailwinds such as an improving U.S. economy, continuing low inflation accompanied by low interest rates, global central bank easing and effective European austerity measures will translate into higher stock prices in 2012. At current valuations for the broad market, our sense is that a good portion of the structural headwinds (a weak U.S. housing market, deleveraging, Europe, and U.S. fiscal imbalances) is already priced into the market.

In the real estate-related sector, we believe that many of these stocks should continue to benefit from generationally low interest rates, depressed new construction activity, modestly improving demand and credit

availability, and attractive stock valuations. Additionally, at long last, there appear to be modest signs of stabilization in the housing market, and increased speculation that additional stimulus to stem the housing crisis will be implemented. This would be welcome.

We are already hard at work in 2012 and energized to produce strong results for you, our shareholders. After devoting the first week of 2012 to reviewing all of the Fund holdings, we are excited about the Fund's investments and optimistic about the prospects for the portfolio. We believe we have assembled a high-quality group of companies with excellent management teams, strong growth prospects, leading competitive positions, liquid balance sheets, and attractive valuations.

I remain a major shareholder of the Baron Real Estate Fund alongside you.

Table VII.
Top 10 holdings as of December 31, 2011

	Quarter End Market Cap (billions)	Investment Value (thousands)	Percent of Net Assets
Wyndham Worldwide Corp.	\$ 5.8	\$935.3	5.9%
Equinix, Inc.	4.8	810.7	5.1
Capital Senior Living Corp.	0.2	767.8	4.9
American Tower Corp.	23.6	552.1	3.5
Golar LNG Partners L.P.	1.2	531.8	3.4
Brookdale Senior Living, Inc.	2.1	497.9	3.1
Hyatt Hotels Corp.	6.2	482.0	3.0
Starwood Hotels & Resorts Worldwide, Inc.	9.4	459.3	2.9
LaSalle Hotel Properties	2.0	452.0	2.9
Brookfield Infrastructure Partners L.P.	3.7	450.1	2.8

Thank you for your continued support.

Sincerely,



Jeffrey Kolitch
Portfolio Manager
January 18, 2012

For more information about this Fund
please scan this QR code with any
bar code reader on your mobile device.



Baron Real Estate Fund is non-diversified, which means it may invest a greater percentage of its assets in fewer issues, and which increases the volatility of its returns and exposes it to potentially greater losses in a given period. In addition to general market conditions, the value of the Fund will be affected by the strength of the real estate markets. Factors that could affect the value of the Fund's holdings include the following: overbuilding and increased competition; increases in property taxes and operating expenses; declines in the value of real estate; lack of availability of equity and debt financing to refinance maturing debt; vacancies due to economic conditions and tenant bankruptcies; losses due to costs resulting from environmental contamination and its related clean-up; changes in interest rates; changes in zoning laws, casualty or condemnation losses; variations in rental income; changes in neighborhood values; and functional obsolescence and appeal of properties to tenants. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

Discussions of the companies herein are not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this report reflect those of the respective portfolio managers only through the end of the period stated in this report. The portfolio manager's views are not intended as recommendations or investment advice to any person reading this report and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

This report does not constitute an offer to sell or a solicitation of any offer to buy securities of Baron Real Estate Fund by anyone in any jurisdiction where it would be unlawful under the laws of that jurisdiction to make such offer or solicitation.