DEAR BARON REAL ESTATE INCOME FUND SHAREHOLDER:

The Baron Real Estate Income Fund (the "Fund') generated strong performance in 2020, gaining 22.30% (Institutional Shares) for the year ended December 31, 2020.

The Fund's 22.30% gain in 2020 substantially outperformed its primary benchmark index, the MSCI US REIT Index (the "REIT Index"), which declined by 8.70%.

For the recent three-month period ended December 31, 2020, the Baron Real Estate Income Fund increased 14.36% (Institutional Shares), exceeding the REIT Index, which generated a 11.16% return.

JEFFREY KOLITCH

PORTFOLIO MANAGER

Retail Shares: BRIFX
Institutional Shares: BRIIX
R6 Shares: BRIUX

Three-Year Anniversary

Three years ago, we launched our second real estate fund, the Baron Real Estate Income Fund. This Fund emphasizes real estate dividend-paying securities, with most of the Fund's investments being REITs.

At that time, we stated that we were optimistic about the long-term prospects for both of our real estate funds – the Baron Real Estate Income Fund and the Baron Real Estate Fund.

We also stated that both funds would be highly complementary to each other:

1. **The Baron Real Estate Fund** (launched December 31, 2009)
   - Primary emphasis: Real estate-related equity securities
2. **The Baron Real Estate Income Fund** (launched December 29, 2017)
   - Primary emphasis: Income-producing REITs

In the last three years, our initial real estate fund that was launched eleven years ago, the Baron Real Estate Fund, has continued to deliver strong performance. For the period ended December 31, 2020, it has been awarded Morningstar's highest five-star rating for its 3-year, 5-year, 10-year, and overall performances. For more on the Baron Real Estate Fund, please see our December 31, 2020 shareholder letter.

We are also pleased to report that our more recently launched real estate fund, the Baron Real Estate Income Fund, has earned special recognition for its achievements marking its 3-year anniversary on December 31, 2020 as follows:

Morningstar Real Estate Category Ratings *(as of December 31, 2020)*

- **Morningstar Overall Rating:**
  - Baron Real Estate Income Fund received a 5-star Overall Morningstar Rating™ among 225 funds.
- **Morningstar 3-Year Rating:**
  - Baron Real Estate Income Fund received a 5-star Morningstar Rating™ for its 3-year performance among 225 funds.

Morningstar Real Estate Category Ranking *(as of December 31, 2020)*

- **Morningstar 3-Year, and 1-Year Ranking:**
  - Baron Real Estate Income Fund ranked in the top 3% of all real estate funds for its' 3-year and 1-year performances among 225 and 248 funds, respectively.

This Morningstar Rating™ is for the Institutional share class only; other classes may have different performance characteristics.

Morningstar calculates the Morningstar Real Estate Category Average performance and rankings using its Fractional Weighting methodology. Morningstar rankings are based on total returns and do not include sales charges. Total returns do account for management, administrative, and 12b-1 fees and other costs automatically deducted from fund assets

The **Morningstar Rating™** for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10- year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

BARON FUNDS 1987

Baron Real Estate Income Fund

The Baron Real Estate Income Fund's cumulative 3-year return of 48.58% (Institutional Shares) (net of fees) substantially exceeds the 6.90% cumulative return of the REIT Index. The Fund's average annual return during this period was 14.11% vs. 2.25% for the REIT Index.

As we embark on the next chapter of the Baron Real Estate Income Fund, we thought it would be an ideal time to illuminate prospective shareholders about the Fund, provide a refresher to current shareholders, and discuss our current thoughts regarding various investment opportunities.

We will address the following topics in this letter:

1. Why we launched the Baron Real Estate Income Fund
2. A review of Baron Real Estate Income Fund's differentiated approach vs. most other REIT funds
3. A comparison of Baron Real Estate Income Fund and Baron Real Estate Fund
4. Allocating capital between the two Baron Real Estate Funds
5. Investing prospects for the Baron Real Estate Income Fund and REITs (*preview:* we are bullish)
6. Our 2021 key investment themes and portfolio composition
7. Our concluding thoughts and observations

Baron Real Estate Income Fund Performance

Table I.
Performance
For periods ended December 31, 2020

	Baron Real Estate Income Fund Retail Shares[1,2]	Baron Real Estate Income Fund Institutional Shares[1,2]	MSCI US REIT Index[1]
Three Months[3]	14.26%	14.36%	11.16%
One Year	22.02%	22.30%	(8.70)%
Three Years and Since Inception (December 29, 2017) (Annualized)	13.93%	14.11%	2.25%
Three Years and Since Inception (December 29, 2017) (Cumulative)	47.87%	48.58%	6.90%

WHY WE LAUNCHED THE BARON REAL ESTATE INCOME FUND

Baron has a long and successful history of investing in real estate.

Since 1987, Baron has invested billions of dollars in real estate-related securities. We believe that long-term investing in real estate and real estate-related companies with, in our view, well-located and well-positioned assets, attractive long-term growth prospects and strong management teams, is a natural extension of the Baron philosophy of investing.

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares and Institutional Shares as of December 31, 2019 was 6.87% and 5.63%, respectively, but the net annual expense ratio was 1.05% and 0.80% (net of the Adviser's fee waivers), respectively. 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 reimburses certain Baron Fund expenses pursuant to a contract expiring on August 29, 2031, unless renewed for another 11-year term 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.

1 The **MSCI US REIT Index** is a free float-adjusted market capitalization index that measures the performance of all equity REITs in the US equity market, except for specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. MSCI is a trademark of Russell Investment Group. The index and the Fund include reinvestment of interest, capital gains and dividends, which positively impact the performance results. The index is unmanaged. The index performance is not Fund performance; one cannot invest directly into an index.

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.

Strong investor demand for income funds.

The search for income producing securities, as interest rates and bond yields have stagnated near historically low levels, has stoked strong investment interest in dividend-focused securities and income funds.

Our clients have expressed interest in a real estate income fund.

Numerous Baron investors have expressed interest in product offerings beyond equity funds to include an income fund that prioritizes a combination of capital appreciation and current income. Considering our strong track record of our REIT investments in Baron Real Estate Fund, and in response to numerous client requests, we launched the Baron Real Estate Income Fund.

A REVIEW OF BARON REAL ESTATE INCOME FUND'S DIFFERENTIATED APPROACH VERSUS MOST OTHER REIT FUNDS

Baron Real Estate Income Fund is differentiated from traditional active and passively managed REIT funds as follows:

1. Most REIT funds are 100% invested in REITs

   In addition to investing in REITs (typically at least 75% to 80% of the Fund), the Baron Real Estate Income Fund also invests in other real estate-related securities.

   The Fund's flexibility allows it to invest approximately 20% to 25% of net assets in non-REIT real estate companies. At times, these companies may present superior growth, income, and/or share price appreciation potential.

2. The Baron expansive approach to investing within the REIT universe

   Many REIT funds limit their REIT investments to companies that are included in their comparative REIT benchmark. Our key focus is identifying compelling REITs and other real estate income companies with attractive share price appreciation potential – regardless of whether the company is part of the REIT benchmark.

   Examples of our current Fund REIT holdings that are not in the REIT benchmark include:

   - Wireless tower REITs such as **American Tower Corp.**, **SBA Communications Corp.**, and **Crown Castle International Corp.**

   Additional REITs that are also not in the REIT benchmark that may be considered for investment include:

   - Timber REITs such as Weyerhaeuser Company and Rayonier Inc.
   - Billboard REITs such as Lamar Advertising Company

3. The Fund may invest in real estate debt and preferred securities

   The Fund invests primarily in real estate equity income securities, but it may also include other real estate income vehicles such as real estate debt and preferred securities.

   If we determine that the Fund is likely to generate superior returns and mitigate risk by investing in real estate debt securities, we may include real estate debt purchases as a small component of the Fund's portfolio.

4. The Fund may invest in international companies

   U.S. companies are our primary focus, but the Fund may also invest in international real estate companies.

5. Other

   Our investments include companies of all market capitalizations, seeking businesses that we believe have sustainable competitive advantages, exceptional management, and good opportunities for long-term and sustainable growth, with attractive dividend yields and valuations.

With these elements and attributes, we believe we offer a differentiated and compelling real estate income fund.

More so than ever, we believe REIT Funds that embrace flexibility and adaptability in their investment approach will be the long-term winners.

A COMPARISON OF BARON REAL ESTATE INCOME FUND AND BARON REAL ESTATE FUND

Baron Real Estate Income Fund is structured as an attractive complement to Baron Real Estate Fund. Although both funds focus on real estate, they differ in significant ways, as highlighted in the table below. As such, we believe our two real estate funds further address the broader and more complete real estate allocation goals of our clients.

Comparison of Baron Real Estate Income Fund and Baron Real Estate Fund

	Baron Real Estate Income Fund	Baron Real Estate Fund
Investment objective	Income & capital appreciation	Capital appreciation
Equity vs. income orientation	Greater than 75% income	Equity
REITs vs. non-REITs	Typically, 75% or more in REITs	Typically, 25% to 30% in REITs
Real estate category focus	Primarily commercial real estate	Commercial & residential real estate

ALLOCATING CAPITAL BETWEEN THE TWO BARON REAL ESTATE FUNDS

It is important to note that the Baron Real Estate Income Fund and the Baron Real Estate Fund complement and balance each other.

Investment goals should be considered in apportioning capital between the two Baron real estate funds.

Priorities may include:

- Dividend yield and/or income;
- Maximizing long-term total return;
- Limiting annual return volatility; and
- Diversification and lower correlation relative to stocks and bonds.

Over the long term, we expect Baron Real Estate Income Fund may experience less performance fluctuation due to its orientation to yield/income and should display somewhat less direct correlation to stocks and bond performance.

Conversely, we anticipate that our original Baron Real Estate Fund may generate higher returns over the long term, due to its "equity-like" nature and growth orientation that prioritizes a broader range of real estate-related categories. However, there may be periods when Baron Real Estate Income Fund may outperform.

Accordingly, we envision that some clients may elect to allocate and balance their total real estate allocation between both Baron real estate funds, as they conclude that the two real estate funds are indeed highly complementary to each other. Note, there is no guarantee that these goals will be met.

INVESTING PROSPECTS FOR THE BARON REAL ESTATE INCOME FUND AND REITS

As we peer into 2021, we believe the previous underperformance of certain REITs and other real estate-related companies in 2020 may lead to outperformance in the year ahead.

Therefore, we believe now is an attractive time to invest in many REITs and the Fund.

1. **Unusual tactical buying opportunity**

   In 2020, the REIT Index significantly underperformed the broader market by a wide margin of 27.10% by declining 8.70% while the S&P 500 Index gained 18.40%.

   REITs have now underperformed the S&P 500 Index for five consecutive years!

   However, we now believe there is a tactical opportunity to acquire shares in several quality REITs. The share prices of these companies have, in our opinion, overshot to the downside and now offer compelling value.

   We expect the dislocation in the share prices of several REITs may reverse in 2021 if COVID-19 vaccinations are widely administered and economic activity resumes.

2. **Many REITs are cheap**

   We believe many REITs are cheap versus stocks, bonds, and private real estate alternatives.

   REITs relative to other equity alternatives

   Following the sharp recovery in the stock market in the last nine months of 2020, the S&P 500 Index ended the year up 18%, the NASDAQ Composite Index up 45%, and global equities (as defined by the MSCI ACWI Index) ended the year up 16%.

   Much of real estate, however, lagged. Several apartment, hotel, office, mall, shopping center, and other REITs declined 20% to 40% this past year in large part due to the pandemic-induced economic downturn.

   In our opinion, the businesses of many of these companies are cyclically depressed, not secularly challenged, and will recover when economic conditions improve.

   Further, the valuation disparity between several real estate securities and other non-real estate stocks is, in our opinion, extreme. The REIT Index, for example, is currently priced at a discounted valuation multiple relative to the S&P 500 Index for the first time since 2009!

   As such, ***we believe the return potential of several segments of real estate is attractive relative to many equity alternatives.***

   Public real estate relative to bonds

   Following the plunge in bond yields to historic lows, bonds offer investors negligible yield and are unlikely to generate sufficient returns for individual and institutional investors.

   We believe segments of commercial real estate may emerge as an attractive surrogate for traditional fixed income investments given strong demand for income-producing assets and historically low global fixed income rates.

   A June 30, 2020 *Wall Street Journal* article noted that two years ago 36% of bonds had yields of less than 2%. The article went on to state that ***about 85% of global bonds yield less than 2%!***

   On the other hand, the dividend yield on REITs currently stands at approximately 3.5%, and several other real estate securities offer compelling total return potential relative to bonds.

   And, so, ***REITs, in our opinion, are attractively valued versus bonds.***

   Public real estate relative to real estate in the private market

   We believe there is a compelling arbitrage opportunity in the public real estate market relative to the private market.

   With last year's sharp correction in several real estate stocks, the valuations of recent private market real estate transactions indicate that it is notably cheaper to buy certain segments of real estate in the public market than in the private market.

3. **We believe the multi-year business prospects for several REIT categories are quite promising**

   Several REIT segments are experiencing tailwinds that are resulting in an acceleration in business fundamentals – industrial warehouse REITs, data center and wireless tower REITs, manufactured housing, single-family home rentals, cold storage companies, and life science real estate REITs.

   The growth in online sales as businesses and consumers relentlessly seek faster delivery bodes well for industrial warehouse REITs.

   The rapid transition to home-based consumer and commercial activity (online shopping, video streaming, working from home with computer screen meetings and conferencing) should benefit data center and wireless tower REITs due to the need to store a greater library of data to conduct and support these virtual online meetings and the need for a greater number of antennae rental space on towers.

   Strong demand for affordable housing should benefit manufactured housing REITs. A desire by households to rent homes in suburbs rather than rent apartments in cities or purchase homes should benefit single-family rental REITs. The acceleration in "e-grocery" penetration should benefit cold storage warehouse REITs, and an increase in funding for health care drug development bodes well for life science office real estate.

4. **The real estate cycle has reset**

   Most real estate cycles tend to last five to seven years, then correct for one to two years, and then a new cycle begins.

   Key factors that often serve as tailwinds at the onset of a real estate cycle and then reverse course and become headwinds during the later stages of a real estate cycle include: interest rates, mortgage rates, central bank policy, inflation, economic growth, residential and commercial construction activity, corporate balance sheet liquidity and debt levels, and the credit markets.

   Following the sharp decline in economic activity in 2020, ***we believe the U.S. real estate cycle has reset and is in the early stages of what we anticipate will be a multi-year recovery***.

In our opinion, several ingredients are in place that will serve as tailwinds and contribute to an improvement in business performance for a large segment of both commercial and residential real estate in the next few years. A sampling of the ingredients includes:

- Historically low interest rates
  - The 10-Year U.S. Treasury Yield currently stands at 0.9% versus its 50-year average of 6.2%!
- Record low mortgage rates
  - The 30-year U.S. fixed mortgage rate of 2.7% compares favorably to its long-term average rate of 7.9%!
- Accommodative central bank policy
  - September 16, 2020: Federal Reserve signals that it intends to keep interest rates near zero through at least 2023.
- Subdued consumer price inflation
  - Significantly below 2% inflation target. May remain subdued due to technological advances.
- An improving economic growth outlook
  - Following a sharp economic correction early in 2020, recent economic and company business results confirm that the U.S. economy bottomed in April and has continued to rebound. We believe a new economic expansion has begun and most economic cycles last 5 to 7 years.
- Modest levels of commercial construction activity
  - COVID-19 and the slowdown in economic growth contributed to a moderation in commercial construction activity in 2020. Modest commercial inventory levels should serve to buttress rents and real estate values.
- Healthy corporate balance sheets
  - Corporate balance sheets are generally in solid shape with ample cash, appropriate debt levels, and staggered debt maturities.
- The share prices and valuations of several REITs and other real estate-related companies remain depressed
  - Valuations are reasonable especially relative to interest rates and many other investment alternatives.

5. **Strong Investor appetite for yield**

   As interest rates and bond yields have fallen to historically low levels, we believe the search for income-producing securities will eventually stoke strong investment interest in dividend-focused securities like REITs and income funds like REIT funds.

   The 3.5% dividend yield of the REIT Index far exceeds the 0.9% yield of the U.S. 10-year Treasury, the 1.5% yield of the S&P 500 Index, and numerous other income alternatives.

   Also, we expect REIT dividends to grow and be reinstated if cash flows improve in 2021.

6. **Diversification benefits**

   According to FactSet, over the last 20 years (through 12/31/2020), REITs have provided diversification benefits due to their low correlation relative to stocks (0.66 versus S&P 500 Index) and bonds (0.21 versus Bloomberg Barclays U.S. Aggregate Index).

7. **Significant private equity capital targeted for real estate provides a valuation floor**

   We think real estate merger and acquisition activity may rebound in 2021.

   It is estimated that approximately $344 billion of capital has now been raised by private equity sources to invest in real estate, which equates to approximately $1.1 trillion of total real estate purchasing capacity, assuming reasonable 70% financing.

8. **Partial inflation hedge**

   Well-located real estate in supply-constrained geographies is often able to provide investors with a partial hedge against inflation and a good protection of value (i.e., ability to raise rents to offset higher operating costs). The price of a property can be measured in relation to the replacement value (current cost of land, materials, and labor that would be required to build a replacement). Since replacement costs tend to rise with inflation, real estate is often viewed as an effective hedge against inflation.

9. **Additional favorable REIT considerations**

   a. *Improving and contracted cash flows* – We anticipate that the following should lead to improving cash flow growth in 2021:

   i. a recovery in operating fundamentals;
   ii. the refinancing of debt at lower interest rates; and,
   iii. acquisitions and development

   Further, most REITs provide strong earnings visibility due to the documented nature of cash flows that are under contract or lease.

   b. *High-quality real estate portfolios* – Over the last decade, REITs have generally acquired higher-quality real estate assets while culling out lower-quality assets.

   c. *Stronger balance sheets versus a decade ago* – Most REITs maintain suitable levels of debt, have high levels of liquidity, and minimal debt maturities in the next few years.

   d. *Historically low financing costs* – Interest rates are likely to remain at historically low levels which is unequivocally bullish for real estate. Low borrowing costs may lead to advantageous refinancing and investment opportunities.

   e. *New construction activity remains at reasonable levels* – New construction activity has moderated due to increased construction and labor costs. This serves to buttress real estate values.

OUR 2021 INVESTMENT THEMES AND PORTFOLIO COMPOSITION

In 2020, we prioritized four key investment themes each of which contributed to the Fund's strong performance.

2020 Investment Themes

1. REITs that specialize in providing technology facilities and services
2. Niche REITs
3. Investments in non-REIT real estate companies
4. Tactical opportunities in REITs

2021 Investment Themes

In the last few months of 2020, we made tactical adjustments to the portfolio, and reoriented the Fund's investment themes. Accordingly, we have incorporated a more balanced mix between traditional real estate growth companies and real estate value opportunities.

Currently, we believe a "barbell approach" to the Fund's 2021 investment themes and portfolio construction is prudent because COVID-19 has led to a wide disparity in share price performance and valuations for several REITs and other real estate-related companies. We expect this valuation gap to narrow if economic activity improves in 2021.

If the extreme valuation gap between the 2020 real estate "winners" and "laggards" narrows over the course of 2021, we will likely reorient a significant majority of the Fund's holdings, once again, toward "best-in-class" REITs and real estate-related growth companies.

Importantly, the Fund's long-term investment philosophy remains the prioritization of "best-in-class" real estate growth companies. We anticipate maintaining this time-tested strategy.

The portfolio manager defines "**Best-in-class**" as well-managed, competitively advantaged, faster growing companies with higher margins and returns on invested capital and lower leverage that are leaders in their respective markets. Note that this statement represents the manager's opinion and is not based on a third-party ranking.

Regarding investment themes for 2021, we continue to believe that multi-year growth prospects for REITs specializing in technology facilities and services, niche REITs, and investments in certain non-REIT real estate companies remain compelling.

We also believe there is an exciting near-term investment opportunity for REITs and certain non-REIT real estate companies that lagged in 2020 from headwinds caused by COVID-19. We expect the business prospects and share prices of several REITs and other real estate laggards to recover in 2021 if COVID-19 vaccinations are widely administered.

2021 investment themes

1. COVID-19 recovery beneficiaries
2. REITs that specialize in providing technology facilities and services
3. Niche REITs

1. COVID-19 recovery beneficiaries

This investment theme encompasses what we call the "epicenter" REITs and non-REIT real estate companies of the 2020 pandemic.

In 2020, certain REITs and other real estate-related businesses that rely on the assembly of people were severely impacted by COVID-19 as they were forced to shut down all or a large part of operations almost without exception. The share prices of many of these companies declined in 2020 and remain well below peak prices.

Examples of COVID-19 recovery beneficiaries include the following real estate categories:

- Hotel REITs
- Office REITs
- Apartment REITs
- Gaming REITs
- Mall REITs
- Shopping Center REITs
- Health Care REITs
- Other REITs
- Casinos & Gaming Operators
- Real Estate Operating Companies

Most of the real estate businesses that we are prioritizing are cyclically depressed – but not secularly challenged. Consequently, we expect the cash flows of many of these real estate businesses to rebound significantly as people become inoculated with COVID-19 vaccines and normalized economic activity resumes.

Despite a recent rebound in the share prices of many of the "COVID-19 recovery beneficiaries," we believe several companies remain discounted to their likely two- to three-year prospective values. Examples include:

Hotel REITs: **Pebblebrook Hotel Trust**, **Park Hotels & Resorts, Inc.**, and **Host Hotels & Resorts, Inc.**

Office REITs: **Douglas Emmett, Inc.**, **Boston Properties, Inc.**, and **Vornado Realty Trust**

Apartment REITs: **Equity Residential**

Gaming REITs: **MGM Growth Properties LLC** and **Gaming and Leisure Properties**, **Inc.**

Mall REITs: **Simon Property Group, Inc.**

Other REITs: **STORE Capital Corporation** and **American Assets Trust, Inc.**

Casinos & Gaming Operators: **Wynn Resorts Ltd.**, **Las Vegas Sands Corporation**, **Penn National Gaming, Inc.**, and **Red Rock Resorts, Inc.**

Real Estate Operating Companies: **Kennedy-Wilson Holdings, Inc.**, **Brookfield Infrastructure Partners L.P.**, and **Brookfield Renewable Partners L.P.**

On December 31, 2020, COVID-19 recovery beneficiary companies represented 38.0% of the Fund's net assets.

Table II.
COVID-19 recovery beneficiaries as of December 31, 2020

	Percent of Net Assets
Casinos & Gaming Operators	11.5%
Real Estate Operating Companies	5.9
Gaming REITs	4.8
Hotel REITs	3.8
Office REITs	3.7
Apartment REITs	2.5
Mall REITs	2.4
Other REITs	3.4
Total	38.0%

2. REITs that specialize in providing technology facilities and services

Several technology-related REITs performed well in 2020, and their current valuations may be, at this point, somewhat less compelling than one year ago. However, while their share prices may not accelerate in the near term to the same extent as other "2021 catch-up" real estate categories, we remain long-term bullish on the prospects for several real estate technology companies.

The impact of technology on real estate is undeniable. The growth in cloud computing, the internet, mobile data and cellphones, and wireless infrastructure are powerful secular drivers that should continue unabated for years and are impacting real estate, along with many other industries. At Baron, we refer to these types of enduring developments as "megatrends."

If anything, the pandemic has accelerated these secular trends as more people conduct business, leisure, residential, and commercial activities online.

Real estate-related companies that embrace and adopt the latest technological advances and innovations remain an important focus for us. Key beneficiaries of the technology revolution include data center REITs, wireless tower REITs, and industrial REITs, among others.

Data Center REITs:

Our data center REITs (**Equinix, Inc.**, **Digital Realty Trust, Inc.**, and **CoreSite Realty Corporation**) are benefiting from the meteoric growth in the outsourcing of information technology, increased cloud computing adoption, and the growth in U.S. mobile data and internet traffic.

The rapid transition to a world of "computer screen meetings and conferencing" should also benefit data centers due to the need to store a greater library of data to conduct and support these virtual online meetings.

Wireless Tower REITs:

Our tower REITs (**American Tower Corp.**, **SBA Communications Corp.**, and **Crown Castle International Corp.**) are, in our view, positioned to grow for several years as the demand for data intensive devices accelerates, and new wireless technologies continue to emerge and improve.

New technological innovations and greater data demand require a greater number of antennae rental space that will continue to benefit tower companies. Like data centers, we expect wireless towers to continue to benefit from increased home-based consumer and commercial activity (online shopping, video streaming, and working from home).

Industrial REITs:

We expect business conditions for the Fund's industrial REIT holdings (**Prologis, Inc.**, **Rexford Industrial Realty, Inc.**, **Terreno Realty Corporation**, and **Duke Realty Corporation**) to rebound and remain strong for several years.

Each of these companies is expected to continue to benefit from robust warehouse demand and increased rents. This is due, in part, to broader e-commerce needs resulting from the accelerated growth of online sales as businesses and consumers relentlessly seek faster delivery.

On December 31, 2020, REITs and non-REIT technology-related real estate companies that we expect to directly benefit from long-term technology growth currently represent approximately 36.8% of the Fund's net assets.

Table III.
Technology-related real estate companies as of December 31, 2020

	Percent of Net Assets
Industrial REITs	11.3%
Wireless Tower REITs	10.5
Data Center REITs	10.1
Non-REIT Technology-Related Real Estate Companies	4.9
Total	36.8%

3. Niche REITs

The Fund sees opportunities in some "unconventional" or "niche" REITs that we believe have the potential to grow faster than a number of traditional or mainstream REITs (i.e., malls, shopping centers, offices, apartments, self-storage).

We believe some niche REITs may benefit from their outsized exposure to secular demand trends and/or reduced exposure to cyclical weaknesses (i.e., elevated construction activity and excess supply) witnessed in some of the traditional REIT peers.

Niche REITs that we favor include:

Manufactured Housing REITs:

We expect our two premier manufactured housing companies in this niche REIT category (**Equity Lifestyle Properties, Inc.** and **Sun Communities, Inc.**) to continue to benefit from favorable demand/supply dynamics.

These companies are the prime beneficiaries of strong demand from budget-conscious home buyers such as retirees and millennials. Demand for these homes is outstripping supply, in part due to high barriers of entry, such as local governmental approvals and certain other factors. Both companies have superior prospects for long-term cash flow growth, plus lower capital expenditure needs than most other REIT categories.

In the aftermath of the economic impact from the Coronavirus, we expect demand for both affordable housing and recreational vehicles to accelerate.

Life Science REITs:

Alexandria Real Estate Equities, Inc. is the leading owner, operator, and developer of collaborative life science office real estate campuses. We anticipate that additional life science office space may be required as more funding is directed towards drug development and pharmaceutical and biotechnology companies increase their budgets for research and development.

Cold Storage REITs:

Americold Realty Trust is a leading owner, operator, and developer of temperature-controlled warehouses with the largest portfolio of temperature-controlled warehouses globally. We believe the company is well positioned to deliver superior growth versus most REITs because of its ability to improve occupancy and rents in its current portfolio, exploit and develop its own real estate pipeline, and to acquire additional temperature-controlled warehouses.

Americold is also poised to benefit from an acceleration in "e-grocery" penetration as grocery stores recognize the increased need for additional automated cold storage facilities to streamline inventory replenishment, largely resulting from the rapid increase in consumer food delivery.

Single-Family Rental REITs:

We are bullish on the prospects for our investment in the single-family rental REIT category (**Invitation Homes, Inc.** and **American Homes 4 Rent**) because we believe the demand outlook for single-family home rentals should continue to outstrip supply, thereby creating a favorable backdrop for strong rent and cash flow growth.

We expect this niche REIT category to continue to benefit from constrained home ownership affordability, high student debt burdens, the preference for flexibility with renting, and the possibility that, in the aftermath of the Coronavirus, more people may opt for single-family rentals rather than multi-family dwellings.

Triple Net REITs:

Our gaming REITs (**MGM Growth Properties LLC** and **Gaming and Leisure Properties, Inc.**) own quality casino and gaming real estate properties. Both have attractive and well-covered dividends, accretive acquisition growth opportunities, and are, in our opinion, compelling investments.

On December 31, 2020, niche REITs represented approximately 28.5% of the Fund's net assets.

Table IV.
Niche REITs as of December 31, 2020

	Percent of Net Assets
Single-Family Rental REITs	7.1%
Triple Net REITs	6.8
Manufactured Housing REITs	6.1
Life Sciences REITs	3.2
Cold Storage REITs	2.3
Other REITs	3.0
Total	28.5%

Baron Real Estate Income Fund currently has investments in several REIT categories and non-REIT real estate companies. Our percentage allocations to these categories vary, and they are based on our research and assessment of opportunities in each category (see Table V. below).

Table V.
Fund investments in REIT categories as of December 31, 2020

	Percent of Net Assets
Non-REIT Real Estate Companies	23.9%
Industrial REITs	11.3
Wireless Tower REITs	10.5
Data Center REITs	10.1
Other REITs	10.0
Single-Family Rental REITs	7.1
Triple Net REITs	6.8
Manufactured Housing REITs	6.1
Hotel REITs	3.8
Office REITs	3.7
Multi-Family REITs	2.5
Mall REITs	2.4
Cash and Cash Equivalents	1.8
Total	100.0%

OUR CONCLUDING THOUGHTS AND OBSERVATIONS

We have consistently stated that **no one has a crystal ball regarding the outlook** for the stock, bond, or real estate markets.

This past year, 2020, was a pointed example of the challenges of predicting the future.

The surprising breakout of a global pandemic – the Coronavirus – was an unexpected curveball that led to unprecedented health, medical, economic, and humanitarian distress. This human tragedy also triggered stock market turmoil early in 2020.

We must remain mindful that the Coronavirus pandemic persists and continues to cause uncertainty for the economic, real estate, and stock market landscape. Additional factors that could weigh on the outlook include political cross currents, interest rate concerns, and geopolitical tensions, to name just a few.

Yet, despite this lack of clarity regarding the economic and market outlook, **as we peer into 2021, we believe there are valid reasons for optimism.**

Our "big picture" view is that several key economic and market risks should recede in the year ahead:

- Many of the key concerns of 2020 – the COVID-19 pandemic, U.S. election controversies, global trade war – should diminish in 2021.
- Widespread inoculation of COVID-19 vaccines should lead to an easing of mobility restrictions, improvement in employment, and a continuation of the economic recovery.
- Corporate earnings should bounce back, fueled by the release of pent-up demand, improving profitability margins, and an increase in corporate investment activity such as mergers & acquisitions and share buybacks.
- The double barrel of exceptionally favorable monetary and fiscal support should begin to work as the global economy further reopens.
- Many companies and consumers have maintained record cash levels due to the uncertain outlook in 2020. We expect corporations and consumers to spend more cash as economic and employment prospects improve. Various companies are likely to increase capital expenditures, pursue mergers and acquisitions, repay debt, and return capital to shareholders in the form of dividends and share buybacks.
- Additional reasons to be optimistic: Inflation concerns seem well off the radar. The U.S. banking system has improved dramatically and is maintaining strong capital ratios. Substantial private capital is in pursuit of real estate and remains supported by widely available debt capital at low interest rates. Fund flows may be directed away from bonds to equities given historically low interest rates and unappealing return prospects for most fixed income alternatives.

Although there are clear differences in the prospects for various REITs and non-REIT real estate companies, **we believe conditions are in place for much of the real estate sector to perform well in the year ahead**.

Baron Real Estate Income Fund Outlook

We remain optimistic about the prospects for the Baron Real Estate Income Fund.

In addition to the reasons cited above, we are also enthusiastic about the prospects for the Fund because:

- We believe the quality of the Fund's holdings is as strong as it has ever been.

  We have carefully and meticulously assembled a portfolio of REITs and non-REIT real estate companies that we believe should provide strong risk-adjusted returns.

  The businesses that we continue to emphasize are well managed, have market-leading positions, possess quality balance sheets, own well-located real estate, and grow cash flow at a faster rate than most of their peers.

  The businesses that we tend to emphasize also have unique competitive advantages, deliver compelling acquisition and development returns, and operate relatively capital efficient business models.

- We believe the Fund is structured to capitalize on compelling investment themes.
  - COVID-19 recovery beneficiaries (*several REIT categories and non-REIT real estate companies*)
  - REITs that specialize in providing technology facilities and services (*data center, wireless tower, and industrial REITs*)
  - Niche REITs (*single-family rental, manufactured housing, cold storage, life science, and gaming REITs*)
- Valuations for several REITs and non-REIT real estate segments are compelling. The valuations of a significant portion of the Fund's real estate companies remain "on sale" at highly appealing prices.
- Classic REIT attributes such as yield will remain in demand. We expect investors to continue to search for yield in a low interest rate environment, and this should aid REITs, other dividend-yielding real estate companies, and real estate companies broadly.

Table VI.
Top 10 holdings as of December 31, 2020

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
American Tower Corp.	$99.7	$3.0	6.3%
Prologis, Inc.	73.6	2.7	5.8
Las Vegas Sands Corporation	45.5	2.4	5.1
Equinix, Inc.	63.6	2.4	5.1
Invitation Homes, Inc.	16.6	2.3	4.9
Equity Lifestyle Properties, Inc.	11.5	1.7	3.6
Alexandria Real Estate Equities, Inc.	24.0	1.5	3.2
Brookfield Infrastructure Partners L.P.	20.6	1.5	3.2
CoreSite Realty Corporation	6.1	1.4	3.0
Colony Capital, Inc.	2.3	1.4	3.0

Final thoughts on the Fund's three-year anniversary

Three years ago, we launched our second real estate fund, the Baron Real Estate Income Fund.

At that time, we stated that we were optimistic about the long-term prospects for both of our real estate funds – the Baron Real Estate Income Fund and the Baron Real Estate Fund.

We also said that both funds would be highly complementary to each other.

On our third anniversary, we are pleased that the Fund delivered strong results and we have continued to be successful in capitalizing on Baron's long history of investing in real estate.

I would like to thank my assistant portfolio manager, David Kirshenbaum, and the other primary members of our real estate research team, David Baron and George Taras, for their excellent work and partnership.

We remain highly determined to diligently research, select, and monitor a high-quality portfolio of companies with solid executive management, strong growth prospects, leading competitive positions, liquid balance sheets, and attractive valuations. We are enthusiastic about our investments and are optimistic about prospects for the portfolio.

I sincerely thank you, our loyal shareholders, and express my utmost gratitude for your past and continuing support during the past three years.

Of course, I proudly continue as a major shareholder of the Baron Real Estate Income Fund, alongside you.

Sincerely,

Jeffrey Kolitch

Jeffrey Kolitch
Portfolio Manager

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectus contain this and other information about the Funds. You may obtain them from its distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

Risks: In addition to general market conditions, the value of the Fund will be affected by the strength of the real estate markets as well as by interest rate fluctuations, credit risk, environmental issues and economic conditions. The Fund invests in companies of all sizes, including small and medium sized companies whose securities may be thinly traded and more difficult to sell during market downturns. Prices of equity securities may decline significantly over short or extended period. Debt or fixed income securities such as those held by the Fund, are also subject to derivatives risk, liquidity risk, and income risk. As interest rates rise, bond prices fall. 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.

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