DEAR BARON REAL ESTATE INCOME FUND SHAREHOLDER:

We are pleased to report that the Baron Real Estate Income Fund (the "Fund") generated strong performance for the most recent quarter ended March 31, 2021.

During this period, the Fund gained 7.58% (Institutional Shares), modestly underperforming the MSCI US REIT Index (the "REIT Index"), which appreciated 8.50%.

Baron Real Estate Income Fund Cumulative Return Since Inception
(December 29, 2017 through March 31, 2021)

- **Baron Real Estate Income Fund: 59.85%**
- MSCI US REIT Index: 15.98%

The Fund's average annual return (net of fees) since inception is 15.53% vs. 4.67% for the REIT Index.

We are also pleased to report that as of March 31, 2021, the Fund received a **5-star Overall Morningstar Rating**.

The Fund achieved the following rankings within the Morningstar Real Estate Category:

- **3-year performance**: Ranked in the top 2% of all real estate funds for its 3-year performance
- **1-year performance**: Ranked in the top 8% of all real estate funds for its 1-year performance

JEFFREY KOLITCH

PORTFOLIO MANAGER

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

We will address the following topics in this letter:

- A chronicle of our active management of the Fund
- Investing prospects for the Baron Real Estate Income Fund and REITs (*preview:* we remain bullish)
- Our investment themes and portfolio composition
- The performance of the Fund in a rising interest rate environment (*preview*: strong historical performance)
- Our concluding thoughts and observations

As of 3/31/2021, the Morningstar Ratings™ were based on 225 share classes for the 3-year and Overall periods. The Baron Real Estate Fund received 5 Stars for both periods. The Morningstar Ratings are for the Institutional Share Class only; other classes may have different performance characteristics.

As of 3/31/2021, the Morningstar Real Estate Category consisted of 248 and 225 share classes for the 1 and 3-year periods. Morningstar ranked Baron Real Estate Income Fund in the 8th and 2nd percentiles for the 1 and 3-year periods, respectively.

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

Table I.
Performance
For periods ended March 31, 2021

	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]	7.48%	7.58%	8.50%
One Year	55.88%	56.17%	36.13%
Three Years	19.17%	19.36%	8.18%
Since Inception (December 29, 2017)	15.32%	15.53%	4.67%
Since Inception (December 29, 2017) (Cumulative)	58.92%	59.85%	15.98%

A CHRONICLE OF OUR ACTIVE MANAGEMENT OF THE FUND

2020 was a particularly active year for our management of the Fund due to the acceleration and emergence of headwinds and tailwinds in certain segments of real estate, the unprecedented economic and social lockdown, and the resulting stock market volatility.

Our decision to implement a more active and aggressive portfolio management playbook than our more typical Baron lower turnover approach produced strong performance results in an extremely challenging and unpredictable year for numerous categories of real estate.

In 2020, the Fund's 22.30% gain, measured favorably against the 8.70% decline of the REIT Index.

In the last few months of 2020 and the first few months of 2021, **we have maintained our elevated active approach of managing the Fund in preparation for this year and the years ahead**.

Though the Fund's long-term investment philosophy remains the prioritization of best-in-class REITs and a much smaller weighting to non-REIT real estate-related growth companies, in recent months we implemented a barbell approach to the Fund's portfolio construction that includes a more balanced mix between best-in-class REITs and non-REIT real estate-related growth and value companies.

We believe our current barbell approach is prudent because COVID-19 led to a wide disparity in share price performance and valuation for several REIT and non-REIT real estate companies.

We have maintained the Fund's investments in competitively advantaged best-in-class REITs and non-REIT real estate companies with long runways for growth. Examples include:

- **Prologis, Inc., American Tower Corp., Equinix, Inc., Invitation Homes, Inc., Alexandria Real Estate Equities, Inc., Equity Lifestyle Properties, Inc., and Rexford Industrial Realty, Inc.**

We have also acquired shares in several REITs and non-REITs that are attractively valued and are "on sale." Examples include:

- **Douglas Emmett, Inc., Simon Property Group, Inc., Vornado Realty Trust, American Assets Trust, Inc., Equity Residential, and Kennedy-Wilson Holdings, Inc.**

In our 2020 fourth quarter letter, we stated that we believed the valuation gap between the 2020 real estate "laggards" and "winners" would narrow if economic activity improved in 2021. This process has begun. In the first quarter, the share prices of many of the 2020 laggards increased sharply (see "Table II") and the share prices of several 2020 winners declined (see "Table III").

Table II.
Examples of 2020 laggards as of March 31, 2021

	2020 Return	YTD 2021 Return
Vornado Realty Trust	–40.47%	23.18%
Simon Property Group, Inc.	–38.95	33.41
American Assets Trust, Inc.	–34.96	13.23
Douglas Emmett, Inc.	–30.88	8.54
Park Hotels & Resorts Inc.	–30.06	25.83
Pebblebrook Hotel Trust	–29.67	29.25
Equity Residential	–23.53	21.84
Host Hotels & Resorts, Inc.	–19.75	15.17
Welltower Inc.	–17.49	11.84
Kennedy-Wilson Holdings, Inc.	–14.99	14.18

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, 2020 was 4.40% and 3.45%, 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.

Table III.
Examples of 2020 winners as of March 31, 2021

	2020 Return	YTD 2021 Return	Percent Change from YTD 2021 High Price
GDS Holdings Limited	81.54%	−13.40%	−29.92%
Brookfield Renewable Partners L.P.	80.80	−0.31	−13.42
Equinix, Inc.	24.23	−4.43	−11.58
SBA Communications Corp.	17.82	−1.39	−1.78
CoreSite Realty Corporation	16.39	−3.34	−13.72
Alexandria Real Estate Equities, Inc.	13.25	−7.21	−7.81

We also said that if the extreme valuation gap between the 2020 real estate winners and laggards narrows over the course of 2021, we would likely reorient the Fund's holdings, once again, toward best-in-class REIT and non-REIT real estate growth companies. Following the sharp divergence in year-to-date performance between real estate value and real estate growth stocks, the risk-reward prospects have started to become more favorable for growth REITs and non-REIT real estate companies.

We continue to believe, however, that maintaining a mix of value and growth real estate stocks is prudent. We expect several real estate growth stocks may begin to perform better in the months ahead given the recent correction in share prices and our expectation for the continuation of strong business results. We also maintain our positive view on real estate value stocks for the following reasons:

- Several 2020 real estate laggards remain attractively valued and "on sale."
- The business results of many of the 2020 real estate laggards–such as office, mall, hotel, and commercial real estate services companies–should improve disproportionately as economic activity rebounds.
- Attractively valued and economically sensitive companies may continue to perform well if interest rates continue to rise.

Unlike passive real estate strategies that replicate a real estate index by owning the entire universe of public real estate companies regardless of the return prospects for individual companies, ***we will continue to actively manage our real estate fund by prioritizing companies with attractive return prospects while de-emphasizing companies with unappealing return prospects***.

Our actively managed approach to investing in real estate has yielded strong long-term results. Since the launch of the Fund more than three years ago on December 29, 2017, the Fund has increased 59.85% cumulatively (net of fees) which compares favorably to the performance of the largest real estate passive strategy, the Vanguard Real Estate ETF ("VNQ"), which increased 25.59%.

Our team remains driven to continue to produce strong long-term results for our shareholders. We will stay vigilant, adaptive, and active regarding the management of the Fund.

INVESTING PROSPECTS FOR THE BARON REAL ESTATE INCOME FUND AND REITS

We continue to believe now is an attractive time to invest in many REITs and the Fund.

1. **We see an unusual tactical buying opportunity.**

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

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

   We continue to 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 continue to offer compelling value.

   We expect the dislocation in the share prices of several REITs will continue to reverse in 2021 as 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

   In 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 remains, in our opinion, extreme. The REIT Index, for example, is 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.***

   Real estate relative to bonds

   We continue to believe segments of commercial real estate will remain an attractive surrogate for traditional fixed income investments given strong demand for income-producing assets and historically low global fixed income rates.

   Real estate has historically been priced to deliver unlevered returns that: (i) exceed the yields on BAA-rated corporate bonds by about 200 basis points; and (ii) approximate the yields on high-yield bonds. According to data provided by *Greenstreet*, real estate is currently priced at a 280-basis point yield premium to BAA corporate bonds versus a 35-year average of 198 basis points. Further, real estate is priced at a 210-basis point premium to high-yield bonds versus a 35-year average of no premium.

   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 remains 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 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 sciences 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 sciences real estate REITs.

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 global 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 1.74% versus its 50-year average of 6.17%!

   - Record low mortgage rates

     The 30-year U.S. fixed mortgage rate of 3.17% compares favorably to its long-term average rate of 7.88%!

   - Accommodative central bank policy

     The Federal Reserve continues to signal that it intends to keep interest rates near zero through 2023.

   - Subdued consumer price inflation

     Inflation remains relatively benign and may remain subdued due to technological advances.

   - An improving economic growth outlook

     Following a sharp economic correction early in 2020, recent economic and corporate results confirm that the global economy is rebounding. We believe a new economic expansion has begun and most economic cycles last five to seven 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 remain at low levels, we believe the search for income-producing securities will stoke strong investment interest in dividend-focused securities like REITs and yield-oriented funds like REIT funds.

   The 3.4% dividend yield of the REIT Index far exceeds the 1.74% 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 typical 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., an 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**

- *Improving and contracted cash flows*

  We anticipate that the following should lead to improving cash flow growth in 2021:

  - a recovery in operating fundamentals;
  - the refinancing of debt at lower interest rates; and
  - acquisitions and development

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

- *High-quality real estate portfolios*

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

- *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.

- *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.

- *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

We continue to prioritize three investment themes for 2021.

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.

Last year, 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 last year 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 two- to three-year prospective values. Examples include:

Hotel REITs: **Host Hotels & Resorts, Inc.**

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

Apartment REITs: **Equity Residential**

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

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

Health Care REITs: **Welltower Inc.**

Other REITs: **STORE Capital Corporation**

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

Real estate operating companies: **Kennedy-Wilson Holdings, Inc.** and **Brookfield Infrastructure Partners L.P.**

On March 31, 2021, COVID-19 recovery beneficiary companies represented 46.2% of the Fund's net assets.

Table IV.
COVID-19 recovery beneficiaries as of March 31, 2021

	Percent of Net Assets
Casinos & Gaming Operators	12.7%
Office REITs	7.2
Real Estate Operating Companies	6.2
Hotel REITs	5.0
Hotel & Timeshare Operators	4.9
Mall REITs	2.9
Apartment REITs	2.2
Health Care REITs	1.8
Other REITs	3.3
Total	46.2%

2. REITs that specialize in providing technology facilities and services

Several technology-related REITs performed well in 2020. We noted in our 2020 fourth quarter letter that valuations were generally less compelling than one year ago and the performance of the stocks may underperform in the near term relative to laggard REIT categories that should benefit if economic growth accelerates in 2021. This has occurred in the first quarter of 2021. We also cited that we remain bullish on the long-term 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.** 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 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 March 31, 2021, REITs and non-REIT technology-related real estate companies that we expect to directly benefit from long-term technology growth currently represent approximately 24.4% of the Fund's net assets.

Table V.
Technology-related real estate companies as of March 31, 2021

	Percent of Net Assets
Industrial REITs	9.3%
Wireless Tower REITs	7.1
Data Center REITs	5.2
Non-REIT Technology-Related Real Estate Companies	2.8
Total	24.4%

3. Niche REITs

The Fund continues to see opportunities in some unconventional or niche REITs that we believe have the potential to grow faster than a number of traditional or mainstream REITs such as malls, shopping centers, offices, apartments, and self-storage REITs.

We believe some niche REITs may benefit from their outsized exposure to secular demand trends and/or reduced exposure to cyclical weaknesses such as elevated construction activity and excess supply witnessed in some traditional REITs.

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 Sciences REITs:

Alexandria Real Estate Equities, Inc. is the leading owner, operator, and developer of collaborative life sciences office real estate campuses. We anticipate that additional life sciences office space may be required as more funding is directed towards drug development and as 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 March 31, 2021, niche REITs represented approximately 22.7% of the Fund's net assets.

Table VI.
Niche REITs as of March 31, 2021

	Percent of Net Assets
Manufactured Housing REITs	5.6%
Single-Family Rental REITs	5.4
Triple Net REITs	4.9
Life Sciences REITs	2.6
Cold Storage REITs	1.5
Other REITs	2.7
Total	22.7%

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 VII below).

Table VII.
Fund investments in REIT categories as of March 31, 2021

	Percent of Net Assets
Non-REIT Real Estate Companies	26.6%
Industrial REITs	9.3
Other REITs	8.5
Office REITs	7.2
Wireless Tower REITs	7.1
Triple Net REITs	6.5
Manufactured Housing REITs	5.6
Single-Family Rental REITs	5.4
Data Center REITs	5.2
Hotel REITs	5.0
Mall REITs	2.9
Multi-Family REITs	2.2
Unclassified	2.1
Health Care REITs	1.8
Self-Storage REITs	1.3
Cash and Cash Equivalents	3.3
Total	100.0%

THE PERFORMANCE OF THE FUND IN A RISING INTEREST RATE ENVIRONMENT

We are mindful that interest rates are currently a top-of-mind topic.

Since bottoming at a historic low of only 0.50% on March 9, 2020, the U.S. 10-year Treasury yield has responded to the double-barrel of extremely accommodative fiscal and monetary policy, a steady improvement in economic growth, and a rise in inflation by increasing to 1.74% on March 31, 2021.

While falling interest rates tend to lower the return on assets investors demand and contribute to the rise in REIT and non-REIT real estate prices (i.e., REIT capitalization rates compress), an increase in interest rates has the potential to be a source of vulnerability for the prices of certain REITs and non-REIT real estate stocks (i.e., REIT capitalization rates increase).

Further, the relative appeal of REIT dividends may diminish in a rising interest rate environment.

Our additional observations regarding interest rates are as follows:

1. **No one has a crystal ball**

   Although we are always mindful of the macroeconomic environment, we do not base our investment decisions on macro forecasts.

   Macro forecasts such as for the direction of interest rates, inflation, the U.S. dollar, and economic growth tend to be hit or miss.

   The events of 2020 are a case in point. We are confident that the onset of a global pandemic, a recession, the collapse in interest rates, and the largest ever decline in the S&P 500 Index in a 4 ½ week period (the S&P 500 Index fell 34% from February 19, 2020 to March 23, 2020) were not on the radar of the 2020 macro forecasters.

   We have cited on several occasions that we agree with Howard Marks, Co-Chairman of Oaktree Capital Management, who believes that successful macro forecasters are "few and far between." In the past, he has noted that:

   - No one knows with clarity the events that are going to transpire.
   - No one knows what the market's reaction to those events will be.

2. **Strong performance track record in declining and rising interest rate environments**

   Since inception on December 29, 2017, the Fund has generated strong performance in declining and rising interest rate environments.

   Declining interest rate environments

   The 10-year U.S. Treasury yield has decreased from 2.41% to 1.74% since the launch of the Fund more than three years ago through March 31, 2021. During this declining interest rate environment, the Fund has increased 59.85% (net of fees), outperforming the REIT Index, which was up 15.98%, by a wide margin.

   In early 2020, when the 10-year U.S. Treasury yield fell sharply from 1.92% to a low of 0.50% on March 9, 2020, the Fund declined 9.16% (net of fees), yet outperformed the REIT Index which declined by 11.56%.

   Rising interest rate environments

   Since bottoming at 0.50% on March 9, 2020, the 10-year Treasury yield has increased 124 basis points to 1.74% as of March 31, 2021. During this period of rising interest rates, the Baron Real Estate Income Fund increased 44.85% on a cumulative basis, which compares favorably to the 12.00% gain of the REIT Index.

3. **The playbook for a rising interest rate environment**

- The Fund may utilize its "playbook" for an environment of accelerated economic and business growth and rising interest rates. Our Baron playbook entails five strategies. They include:
- Carefully reviewing and updating our allocations to REITs and other dividend-yielding securities. Higher yields can limit the attractiveness of dividend stocks such as REITs (although that is not always the case).
- Focusing on short lease duration REITs and non-REIT real estate companies such as hotels that can re-price more often, grow faster, and better offset increases in interest rates.
- Emphasizing real estate-related companies and sectors that will most likely benefit from an improvement in the economy.
- Owning REITs and non-REIT real estate companies with compelling growth prospects, including organic growth (cyclical and/or secular) and external growth (development projects and acquisition prospects).
- Investing in companies with strong balance sheets that are less sensitive to interest rate increases.

Our playbook for a rising interest rate environment may require modifications because every market environment is distinct. For example, the share prices of many REITs declined sharply in 2020 despite the drop in interest rates. And, as interest rates have increased in the first few months of 2021, the share prices of many REITs have rebounded sharply.

OUR CONCLUDING THOUGHTS AND OBSERVATIONS

In 2018, Morgan Stanley published a report titled *"The End of Easy."* In that report, the authors noted that the stock market performance in the prior nine years had exceeded the performance of the economy due to multiple positive tailwinds that included low inflation, historically low interest rates, and positive U.S. policy catalysts (e.g., tax reform).

Looking forward, however, the authors predicted that ***"the end of easy"*** stock market performance may be approaching, as the positive effects of moderate growth, low inflation, low interest rates, and an accommodative Fed (the goldilocks environment) start to moderate. The essence of the report was that when this occurs, the economy may outperform the stock market.

Fast forward to 2020 and 2021. Last year, the share price performance of several companies exceeded the performance of the economy. And now, in 2021, perhaps the "end of easy" has arrived once again. Recent reports regarding job growth, consumer confidence, and consumer spending have all been quite strong. Economic growth is accelerating. Interest rates and inflation have been increasing in response to strong economic data. In the first quarter, stock market volatility and the wide divergence in company share price performance portends that it will be trickier to navigate the investing landscape in the months ahead.

We continue to be of the view, however, that no one has a crystal ball regarding how macroeconomic changes, political events, and central bank actions may unfold, and what the market's reaction will be to those events.

Our antenna will remain up. We will continue to monitor those factors that influence real estate most directly such as construction activity, demand prospects, lending practices, interest rates and credit spreads, bank liquidity, and valuations. We also weigh macro dynamics that could impact certain segments of real estate such as economic growth, inflation, interest rates, oil prices, and the strength of the U.S. dollar.

We continue to believe there are valid reasons for optimism:

- Widespread inoculation of COVID-19 vaccines is leading to an easing of mobility restrictions, an improvement in employment and economic growth.
- Corporate earnings have begun to bounce back, fueled by the release of consumer 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 is aiding the economic recovery.
- Many companies and consumers have maintained record cash levels due to the uncertain outlook in 2020. Corporations and consumers have begun to spend more cash as economic and employment prospects improve. Various companies are increasing capital expenditures, pursuing mergers and acquisitions, repaying debt, and returning capital to shareholders in the form of dividends and share buybacks.
- 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.

Although there are clear differences in the prospects for various residential and commercial real estate companies, **we continue to believe investment prospects for much of public real estate remain attractive:**

- The performance of several real estate companies lagged in 2020 largely due to the Coronavirus headwind that led to a sharp slowdown in business activity for hotels, urban apartment and office landlords, malls and shopping centers, casinos, and other real estate categories. Last year's real estate headwinds have begun to recede, and we expect this trend to continue in the months ahead.
- Several real estate companies remain "on sale" and are attractively valued relative to equity, fixed income, and private real estate alternatives.
- The real estate cycle has reset, and we believe the multi-year outlook is attractive fueled by improving prospects for demand, subdued construction inventory levels, strong and liquid balance sheets, and still historically low interest rates.
- Much of real estate was in the crosshairs of the pandemic in 2020 given the inability to of people to assemble. Looking forward, we expect real estate to be one of the key beneficiaries of an economic reopening.

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

- We continue to believe the Fund is comprised of quality companies.

  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 own are well managed, have market-leading positions, possess quality balance sheets, own well-located real estate, and grow cash flow at faster rates 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.

- Valuations for several REITs and non-REIT real estate segments remain compelling.

  The valuations for a 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 VIII.
Top 10 holdings as of March 31, 2021

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Prologis, Inc.	$ 78.4	$2.1	4.7%
Las Vegas Sands Corporation	46.4	2.1	4.7
Red Rock Resorts, Inc.	3.8	1.7	3.7
Equinix, Inc.	60.7	1.7	3.7
Brookfield Infrastructure Partners L.P.	22.2	1.7	3.7
American Tower Corp.	106.2	1.6	3.6
Invitation Homes, Inc.	18.1	1.4	3.0
Simon Property Group, Inc.	37.3	1.3	2.9
Douglas Emmett, Inc.	5.5	1.3	2.9
Pebblebrook Hotel Trust	3.2	1.3	2.9

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

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

Sincerely,

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. 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 cleanup; 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.

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.

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 an offer or solicitation.

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