Baron Real Estate Income Fund

DEAR BARON REAL ESTATE INCOME FUND SHAREHOLDER:

In the most recent three-month period ended September 30, 2021, the Baron Real Estate Income Fund (the "Fund") declined a modest 1.61% (Institutional Shares), underperforming its primary benchmark index, the MSCI US REIT Index (the "REIT Index"), which increased 0.75%.

For the first nine months of 2021, the Fund increased 14.76%.

We are pleased to report that as of September 30, 2021, the Fund retained its **5-Star Overall Morningstar Rating™** and has remained in the top 3% of all real estate funds for its 3-year performance.

For our more detailed thoughts on the Fund's recent performance, please refer to our "A Review of Recent Activity and Performance" section later in this letter.

We will address the following topics in this letter:

- A review of recent activity and performance
- A REIT market update (*preview*: strong start to 2021, and we remain bullish)
- Key takeaways from recent REIT meetings and conferences
- Our investment themes and portfolio construction
- Interest rates and inflation and their impact on real estate
- Concluding thoughts

JEFFREY KOLITCH

PORTFOLIO MANAGER

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

As of 9/30/2021, the Morningstar Ratings™ were based on 231 share classes for the 3-year and Overall periods. The Baron Real Estate Income Fund received 5 Stars for both periods. The Morningstar Ratings are for the Institutional Share Class only; other classes may have different performance characteristics. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures.

As of 9/30/2021, the Morningstar Real Estate Category consisted of 246 and 231 share classes for the 1- and 3-year periods. Morningstar ranked Baron Real Estate Income Fund in the 69th and 3rd 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.

© 2021 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

BARON FUNDS 1987

Baron Real Estate Income Fund

Baron Real Estate Income Fund Performance

Table I.
Performance
For periods ended September 30, 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]	(1.68)%	(1.61)%	0.75%
Nine Months[3]	14.48%	14.76%	22.15%
One Year	30.80%	31.24%	35.77%
Three Years	19.15%	19.37%	8.82%
Since Inception (December 29, 2017)	15.07%	15.29%	7.37%
Since Inception (December 29, 2017) (Cumulative)	69.27%	70.51%	30.57%

Recent Activity

A REVIEW OF RECENT ACTIVITY AND PERFORMANCE

Recent Activity

Like our portfolio management playbook employed in 2020, we maintained our unusually elevated active approach to managing the Fund in the first nine months of 2021 due to the acceleration and emergence of headwinds and tailwinds in certain segments of real estate, the unprecedented economic and social lockdown and reopening, and the resulting stock market volatility.

Table II.
Top net purchases for the quarter ended September 30, 2021

	Quarter End Market Cap (billions)	Amount Purchased (millions)
AvalonBay Communities, Inc.	$30.9	$4.4
Equity Residential	30.3	3.3
Ventas, Inc.	21.7	3.0
Camden Property Trust	14.8	1.7
Travel + Leisure Co.	4.7	1.6

In the most recent quarter, we acquired shares or made additional purchases in three apartment REITs. We remain optimistic about the prospects for many apartment REITS and other residential-related real estate companies and have categorized residential-related real estate as one of our key investment themes. Please see our "Investment Themes and Portfolio Construction" section later in this letter for our more detailed thoughts on the case for residential-related real estate.

The three apartment REITs we purchased or added to in the most recent quarter are:

- **AvalonBay Communities, Inc.**: AvalonBay is a REIT that owns a $38 billion portfolio of high-quality apartments. The company primarily operates in the West and East Coasts (Los Angeles, Boston, Suburban Virginia, San Jose, Oakland, Northern New Jersey, New York, Seattle, San Francisco) and is an active and talented developer. The company maintains an excellent and liquid balance sheet that provides the company with a competitive advantage relative to many private developers.
- **Equity Residential**: Equity Residential is the largest U.S. apartment REIT with a portfolio valued at $45 billion. The company primarily focuses on major markets such as Los Angeles, Seattle, San Francisco, Boston, and New York, but has begun to also prioritize Sun Belt markets and other regions like Denver. Like AvalonBay, Equity Residential maintains a strong balance sheet and liquidity position. We recently spent time with management and are encouraged about the company's prospects for growth in the year ahead.
- **Camden Property Trust**: Unlike AvalonBay and Equity Residential, Camden, an apartment REIT that owns a $18 billion portfolio, prioritizes the Sun Belt markets (Houston, Atlanta, Phoenix, Dallas, Orlando, Charlotte, Raleigh-Durham). Like most of its apartment REIT peers, Camden maintains an excellent balance sheet, and we expect the continuation of strong operating fundamentals.

We recently acquired shares in **Ventas, Inc.**, a health care REIT that owns a $30 billion portfolio of senior housing, medical office, hospitals, and life science properties. The company's scale allows it to swiftly act on large investment opportunities. We believe the company's senior housing portfolio, which represents approximately 45% of assets, should deliver improved operating results as the headwinds from COVID-19 and the Delta variant subside. We also believe the shares remain attractively valued and offer prospects for strong total shareholder returns.

In September, we attended an investor day with the management team of **Travel + Leisure Co.**, a leading timeshare and hospitality company. We are encouraged by management's four-year growth plan which includes expectations to grow earnings at a compound annual growth rate of 17% to 22% annually. Management also expects to generate approximately $3 billion of cumulative cash flow in the next four years which may be used for dividends, share repurchases, strategic mergers and acquisitions, and

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, 2032, 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. The index and the Fund include reinvestment of interest, capital gains and dividends, which positively impact the performance results. The index is unmanaged. 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.

reinvesting in the business. We recently acquired additional shares that we believe are attractively valued and offer compelling prospects for strong shareholder returns in the next few years.

Table III.
Top net sales for the quarter ended September 30, 2021

	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
GDS Holdings Limited	$12.1	$1.6
Vornado Realty Trust	8.0	1.2
Americold Realty Trust	8.1	1.1
CoreSite Realty Corporation	7.0	0.9
Las Vegas Sands Corporation	34.6	0.9

In the most recent quarter, we exited the Fund's China-centric holdings including:

- **GDS Holdings Limited**: Following several years of delivering strong shareholder returns for the Fund, we exited our position in GDS, the leading developer and operator of data centers in China. Though we hold management in high regard and believe there is potential for strong long-term growth, we are uncomfortable with the political landscape in China, including the scrutiny of the technology industry. We will continue to monitor developments and perhaps acquire shares again in the future.
- **Las Vegas Sands Corporation**: In the most recent quarter, we exited the Fund's holdings in Las Vegas Sands (and **Wynn Resorts Ltd.**) due to: (i) ongoing COVID-19-related travel restrictions in China, Macau, and Singapore; and (ii) the Macau government's decision to tighten its casino regulatory oversight.

In the third quarter, we reduced the Fund's investment in **Vornado Realty Trust**, a REIT that owns a high-quality portfolio of office and street retail assets concentrated in New York City, and redeployed the capital to other REIT investment opportunities. As economic activity improves and employees return to work, we expect leasing and occupancy trends to improve. At its recent price of $43, we believe the shares are attractively valued at an approximate 40% discount to our estimate of net asset value. The stock's current dividend yield is approximately 5%.

Following several quarters of disappointing quarterly results, we exited the Fund's investment in **Americold Realty Trust**, a cold-storage REIT, and reallocated the capital to other REITs that we believe offer superior long-term return potential.

We recently trimmed the Fund's position in **CoreSite Realty Corporation**. CoreSite is a REIT that operates a high-quality real estate portfolio of 25 well-located real estate data centers in 8 markets in the U.S. We believe the company is poised for a positive inflection in cash flow growth in the next few years. In our opinion, the company is attractively valued relative to its public data center peers and recent private market transactions.

Recent Performance

Following two straight years of strong annual returns for the Baron Real Estate Income Fund (22.30% in 2020 and 36.54% in 2019) and exceptionally strong relative outperformance versus the REIT Index, the Fund's 2021 relative performance through September 30, 2021 is trailing that of the REIT Index. Factors that have weighed on year-to-date relative performance include the Fund's Asia-focused real estate investments, which we recently exited, the strong year-to-date performance of certain value REITs (e.g., shopping centers and retail malls), and a few individual stock selection mistakes.

In the past, there have been periods when the Fund has temporarily trailed its benchmark. The Fund has a track record of bouncing back. Our team remains driven, hard at work, and we are optimistic that we will, once again, deliver strong long-term relative performance for our shareholders as we have done over the years.

Table IV.
Top contributors to performance for the quarter ended September 30, 2021

	Quarter End Market Cap (billions)	Percent Impact
Red Rock Resorts, Inc.	$ 6.0	0.51%
MGM Growth Properties LLC	10.3	0.21
Invitation Homes, Inc.	22.8	0.19
Prologis, Inc.	92.8	0.19
Sun Communities, Inc.	21.5	0.19

The shares of **Red Rock Resorts, Inc.**, a real estate gaming, development and management company that generates 100% of its cash flow in the Las Vegas Locals market, continued to perform well in the most recent quarter. We remain optimistic about the long-term prospects for the company given the quality of its 100% owned real estate assets, the attractive and expanding Las Vegas Locals market (strong population growth), and the company's impressive growth and free cash flow prospects. We believe the shares could appreciate by approximately 50% in the next few years.

In the most recent quarter, **MGM Growth Properties LLC**, a gaming REIT, announced that it would be acquired by VICI Properties, another gaming REIT, in a $17 billion strategic acquisition. The combined company will become America's largest owner of experiential real estate and will improve MGM's diversification, scale, and cost of capital.

The shares of **Invitation Homes, Inc.** continued to perform well in the most recent quarter following strong business results. Invitation Homes is the largest single-family home leasing company in the U.S. with approximately 80,000 homes concentrated in California, Florida, Georgia, Arizona, Seattle, and the Carolinas. Its primary business strategy focuses on acquiring, renovating, leasing, and operating single-family homes as rentals. We are bullish about the long-term prospects for the company given multiple growth opportunities which include: i) significant pent-up demand from the millennial generation to rent single-family homes versus a backdrop of constrained inventory (which we expect will lead to rental and occupancy growth); ii) acquisitions of homes in high-growth geographic markets; and iii) the expansion of ancillary home services for residents (e.g., enhanced smart home, pest control, landscape, and pet services).

Following strong quarterly results, the shares of **Prologis, Inc.** continued to increase this quarter. Prologis is a REIT that owns a $40 billion global industrial portfolio. The company continues to benefit from robust demand for its warehouse facilities driven by the growth of e-commerce and the need for infill real estate locations to service "last mile" delivery.

Table V.
Top detractors from performance for the quarter ended September 30, 2021

	Quarter End Market Cap or Market Cap When Sold (billions)	Percent Impact
DigitalBridge Group, Inc.	$ 3.0	–0.61%
GDS Holdings Limited	12.1	–0.37
Vornado Realty Trust	8.0	–0.26
Ventas, Inc.	21.7	–0.24
Americold Realty Trust	8.1	–0.22

Following exceptionally strong performance in the first six months of 2021 when its stock price appreciated 64%, the shares of **DigitalBridge Group, Inc.**, a digital infrastructure REIT that invests in data centers, macro-cell towers, fiber networks, small-cell networks and other data infrastructure-related categories, declined in the most recent quarter. We recently met with CEO Marc Ganzi, who we hold in high regard, and remain optimistic about the company's long-term growth prospects and share price appreciation potential.

Despite strong quarterly operating results, the shares of **GDS Holdings Limited**, the leading developer and operator of data centers in China, declined sharply for the period held due to concerns about China's regulatory backdrop and uncertainty around the ultimate impact on the leading technology companies many of whom are key customers of GDS. We exited the Fund's position in the company.

The shares of **Vornado Realty Trust**, a REIT that owns a high-quality portfolio of office and street retail assets concentrated in New York City, declined in the most recent quarter likely due in part to the Delta variant and concerns that it will delay a return to the office for several companies. As economic activity improves and employees return to work, we expect leasing and occupancy trends to improve. At its recent price of $43, we believe the shares are attractively valued at an approximate 40% discount to our estimate of net asset value. The stock's current dividend yield is approximately 5%.

The shares of **Ventas, Inc.**, a health care REIT that owns a $30 billion portfolio of senior housing, medical office, hospitals, and life science properties, declined modestly after we acquired shares in mid-July. We remain optimistic about the prospects for the company. Ventas' scale allows it to swiftly act on large investment opportunities. We believe the company's senior housing portfolio which represents approximately 45% of assets should deliver improved operating results as the headwinds from COVID-19 and the Delta variant subside. We also believe the shares remain attractively valued and offer prospects for strong total shareholder returns.

A REIT MARKET UPDATE

At the end of 2020, we stated that we believed REITs would perform well in 2021. In the first nine months of 2021, the REIT Index increased 22.15%, outperforming the S&P 500 Index, which gained 15.92%.

Why REITs Performed Well YTD

1. **Much of real estate lagged in 2020**, in part because the business models of several segments of real estate – apartments, office, retail malls, shopping centers, hotels – are based on people assembling. These businesses have been in the bullseye of the pandemic recession. This headwind has begun to reverse. 2020: S&P 500 Index +18%, NASDAQ Composite Index +45%, Global Equities +16%, and REIT Index declined 9% with many REITs down 20% to 40%!
2. **Several segments of public real estate have been attractively valued** relative to equity, bond, and private real estate alternatives.
3. **Real estate is at the doorstep or the very early stages of a new cycle**. We believe the ingredients are in place for real estate to perform well and real estate cycles tend to last five to seven years.
4. **REITs and real estate generally should be one of the prime beneficiaries of an improvement in economic conditions** if, in fact, a large percentage of the population becomes vaccinated.
5. **Certain REITs offer inflation protection characteristics.** For our more complete thoughts on this topic please see the "Interest Rates and Inflation and Their Impact on Real Estate" section later in this letter.

We Think REITs Can Continue to Perform Well

1. **We are still in the relatively early days of the real estate recovery.**
2. **Business fundamentals have stabilized, and, in many cases, have begun to rebound.**
3. **REIT growth prospects are encouraging.**

   Growth fueled by broadly improving demand and constrained supply and growth through acquisitions, development, and redevelopment should, in many cases, accelerate cash flow growth.
4. **Balance sheets are strong.**

   Although credit access is available at historically low financing rates, most REITs are maintaining strong and liquid balance sheets and are not using debt excessively relative to company-generated cash flow.
5. **Many REITs remain on sale in the public markets.**

   We see a shift from multiple expansion or cap rate compression to earnings growth as the key driver of REIT returns going forward. However, the valuations of several REITs remain discounted and offer prospects for cap rate compression and growth.
6. **Certain REITs offer inflation-protection characteristics.**

   Should inflation continue to rear its head, some REITs serve as a hedge and provide inflation-protection characteristics such as annual rent escalators, short-lease durations, and pricing power within supply-constrained markets.

And so, **we remain bullish.**

KEY TAKEAWAYS FROM RECENT REIT MEETINGS AND CONFERENCES

We have remained busy participating in REIT management meetings (mostly through Zoom!) and conducting our ongoing research. September was a notably active month for real estate conferences and meetings. We are encouraged by what we have learned.

Business prospects continue to improve for several REIT categories that lagged in 2020 largely due to the Coronavirus headwind that led to a sharp slowdown in business activity – examples include hotels, apartments, office landlords, malls and shopping centers, health care, and gaming REITs.

Other REITs less impacted by COVID-19 are benefiting from tailwinds that should lead to ongoing strength in business fundamentals – industrial warehouse REITs, data center and wireless tower REITs, manufactured housing REITs, single-family home rental REITs, and life sciences real estate REITs.

Our summary observations for various REIT categories are as follows:

Apartment REITs

Occupancy and rents are improving and public valuations, in some cases, remain at discounts to recent private market transactions. Management teams expect strong growth in 2022.

Office REITs

Return to work plans have been delayed by the Delta variant, but the continued reopening of cities is leading to an uptick in leasing volumes. We believe most office REITs are currently valued at significant discounts to replacement cost.

Industrial Warehouse REITs

Very strong business fundamentals fueled by growth in online sales as businesses and consumers relentlessly seek faster delivery bodes well for the continuation of excellent tenant demand for industrial warehouse REITs.

Retail REITs

Tenant demand is improving. Foot traffic, retail sales, and tenant health have rebounded. We believe the growth prospects for the largest mall REIT, **Simon Property Group, Inc.**, remain compelling.

Self-Storage REITs

Demand for self-storage real estate remains strong driven by the strength of the housing market and increasing mobility (pandemic-induced relocations and hybrid work). Elevated construction costs are constraining new construction.

Health Care REITs

Senior housing occupancy has bottomed, construction activity is modest, thereby setting the stage for more favorable cash flow prospects.

Hotel REITs

Leisure travel is accelerating, business travel is re-emerging (albeit slowly), and hotel REITs are currently valued at steep discounts to replacement cost.

Gaming REITs

Casino gaming business is strong in Las Vegas and most regional markets. We believe gaming REITs are attractively valued relative to private market transactions. M&A activity has picked up.

Data Center REITs

Secular demand trends of cloud adoption and IT outsourcing remain intact. The price paid by Blackstone for its recent $10 billion acquisition of data center REIT, QTS Realty Trust Inc., implies that some data center REITs are attractively valued and could be take-out candidates.

Wireless Tower REITs

The long-term growth prospects for tower REITs remain encouraging given strong secular growth expectations for mobile data usage, 5G technology, and "connected homes and cars," which will require increased wireless bandwidth and increased spending by the mobile carriers.

Single-Family Rental REITs

Limited inventory combined with a strong desire by households to rent homes in suburbs rather than rent apartments in cities or purchase homes is leading to robust rent growth for single-family rental REITs.

Life Science REITs

An increase in funding for health care drug development is contributing to demand for life science buildings that continues to exceed supply, resulting in strong business fundamentals in key geographic markets.

Manufactured Housing REITs

Demand for affordable housing remains strong against a backdrop of limited supply.

Health Care REITs

Improved performance in the hard-hit senior housing sector, although slowed recently by the Delta variant. Medical office buildings continue to perform well.

Cold Storage REITs: Supply chain challenges and labor cost inflation are weighing on growth and margins, with issues expected to persist through at least mid-2022.

Student Housing REITs

Showing signs of improvement.

OUR INVESTMENT THEMES AND PORTFOLIO CONSTRUCTION

Investment Themes

We are currently prioritizing three investment themes:

- COVID-19 recovery beneficiaries
- Residential-related real estate
- Intersection of technology and real estate

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 people assembling 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.

There is a broad swath of COVID-19 recovery beneficiaries including hotel, office, apartment, gaming, mall, and health care REITS as well as casinos & gaming operators and 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 more people become inoculated with COVID-19 vaccines and normalized social and 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., Park Hotels & Resorts Inc., and **Pebblebrook Hotel Trust**

Office REITs

Douglas Emmett, Inc., Vornado Realty Trust, JBG SMITH Properties, and **Paramount Group, Inc.**

Apartment REITs

Equity Residential, AvalonBay Communities, Inc., and **Camden Property Trust**

Gaming REITs

Gaming and Leisure Properties, **Inc.**

Mall REITs

Simon Property Group, Inc.

Health Care REITs

Ventas, Inc.

Timeshare & Gaming Companies

Red Rock Resorts, Inc., **Penn National Gaming, Inc.**, and **Travel + Leisure Co**.

Real Estate Services Companies

Kennedy-Wilson Holdings, Inc.

On September 30, 2021, COVID-19 recovery beneficiary companies represented 35.9% of the Fund's net assets.

Table VI.
COVID-19 recovery beneficiaries as of September 30, 2021

	Percent of Net Assets
Hotel REITs	9.6%
Office REITs	8.9
Timeshare & Gaming Companies	8.1
Health Care REITs	4.0
Mall REITs	3.8
Commercial Real Estate Services Companies	1.5
Total	35.9%

2. Residential-related real estate

We believe the case for residential real estate is compelling.

The key component underpinning our favorable view is due to a structural underinvestment in the construction of residential real estate. Today, the U.S. is building the same number of homes annually as it did in 1959 – approximately 1.4 million homes, which also equals the 60-year average. This annual construction figure is shockingly low when one considers that the U.S. population is more than 150 million people larger than it was in 1959 – 330 million people today versus 178 million people in 1959! Recently, the Census Bureau released a study that the U.S. constructed only 7 million homes over the last 10 years while 12 million households were created – leading to a supply shortage of 5 million homes solely in this time.

Demand prospects are also encouraging especially from the approximately 73 million millennials – ages 25 to 40 – many of whom are now looking to buy or rent a home. The large imbalance between pent-up housing demand and low construction levels bodes well for multi-family apartment rentals, single-family home rentals, and manufactured homes, as well as new single-family home purchases (as long as mortgage rates and home prices do not spike to levels that would deter homebuyers).

- **Robust demand**

  We believe that current demand drivers remain supportive for apartments, single-family rental homes, and manufactured homes.

  Apartment REITs

  Demand for coastal apartments has snapped back faster than anyone could have anticipated with current market rents at or above pre-COVID levels and landlord rental concessions virtually non-existent today. Near-term demand is being supported by:

  - Residents who temporarily left, returning to cities once they could enjoy their entertainment and social aspects;
  - Roommates taking the opportunity to decouple with a desire for more space given work-from-home flexibility;
  - Bargain hunters taking advantage of vacant inventory and landlord concessions during COVID to trade up or move to neighborhoods that were unaffordable before; and,
  - Demand from two classes of graduates (2020 and 2021) hitting the market simultaneously with offices beginning to reopen in the fall.

  All these trends rapidly are leading to limited inventory availability and significant pricing power for landlords. Note that the majority of the urban apartment demand is driven by tenants who are in their early thirties or younger.

  Single-Family Rental REITs

  Demand for suburban life or "the American Dream" also continues unbated. The primary renter of a single-family home is 39 years old, has two kids, a pet and is seeking good schools with an easy commute. While some families may have "pulled forward" their decision to move during the pandemic, we expect the multi-year demand drivers to endure. Recently signed new leases approached 20% year-over-year growth with high single-digit growth on renewals and nearly full occupancy. There remain 73 million millennials who represent future demand for single-family rental homes. Key drivers of demand include a "rentership" culture among millennials while prioritizing experiences over possessions, limited supply of entry level housing, high student debt burdens/ limited savings for a down payment and the increasing institutionalization of the asset class with professionally managed homes.

Manufactured Housing REITs

In the aftermath of the economic impact from COVID-19, we expect demand for affordable housing to continue to benefit manufactured housing REITs.

- **No affordability concerns**

  Affordability remains a key topic of conversation given the historically high absolute rental growth we are witnessing in the reported results of both single-family and multi-family landlords. While rents have increased, the monthly income to rent ratios remain at or even above historical levels (approximately 5 times). Wage growth has remained strong and many of our companies target an affluent demographic that has saved a significant amount of money over the last 12 to 18 months. In other words, the tenant credit quality has improved despite the unprecedent rent growth, which should give landlords the ability to increase rents further, once again, on renewals.

- **Strong absolute and relative growth**

  The growth outlook for residential real estate is one of the strongest across most categories of REITs given: i) strong imbedded mark-to-market rents; ii) cycling leases that were signed with heavy concessions during pandemic lows; and iii) burning off bad debt expense. These factors, combined with strong continued demand, should lead to outsized overall growth relative to REITs overall. Recently, Mark Parrell, CEO of **Equity Residential**, stated: "2022 is going to be a year of acceleration for us, we think. And we believe the company is going to post the best numbers in its history in terms of same-store revenue growth."

- **Short-lease duration real estate**

  We have often discussed short-lease duration real estate as a good inflation hedge with the ability to reset rents every year–we believe apartment, single-family home rental, and manufactured housing landlords will continue to enjoy pricing power that could not only lead to strong top-line growth but margin expansion as well.

- **Attractive values**

  Despite strong stock performance in 2021 to date, we believe, based on transactions we have observed, that residential real estate REITs still offer compelling value relative to their imbedded growth and private market values. We believe if some of these assets traded in the private market today, they could fetch premiums of 30% or more.

On September 30, 2021, residential-related real estate represented 26.7% of the Fund's net assets.

Table VII.
Residential-related real estate as of September 30, 2021

	Percent of Net Assets
Multi-Family Apartment REITs	12.2%
Single-Family Rental REITs	9.0
Manufactured Housing REITs	5.5
Total	26.7%

3. Intersection of technology and real estate

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 nine months of 2021. Now, as then, we are 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.

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.

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 (e.g., online shopping, video streaming, and working from home).

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.

Industrial REITs

We expect business conditions for the Fund's industrial REIT holdings (**Prologis, Inc.**, **Rexford Industrial Realty, Inc.**, 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 September 30, 2021, REITs and non-REIT technology-related real estate companies that we expect to directly benefit from long-term technology growth represented 23.3% of the Fund's net assets.

Table VIII.
Intersection of technology and real estate as of September 30, 2021

	Percent of Net Assets
Wireless Tower REITs	7.5%
Industrial REITs	7.3
Data Center REITs[1]	6.9
Residential-Related Technology Companies	1.6
Total	23.3%

1 - Data Center REITs include infrastructure-related REIT DigitalBridge Group, Inc.

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

Table IX.
Fund investments in REIT categories as of September 30, 2021

	Percent of Net Assets
Non-REIT Real Estate Companies	14.8%
Multi-Family REITs	12.2
Hotel REITs	9.6
Single-Family Rental REITs	9.0
Wireless Tower REITs	7.5
Industrial REITs	7.3
Office REITs	6.3
Manufactured Housing REITs	5.5
Data Center REITs	4.7
Other REITs	4.7
Triple Net REITs	4.5
Health Care REITs	4.0
Mall REITs	3.9
Self-Storage REITs	3.3
Cash and Cash Equivalents	2.7
Total	100.0%

INTEREST RATES AND INFLATION AND THEIR IMPACT ON REAL ESTATE

We are mindful that interest rates and inflation are a current, top-of-mind topic.

It appears that the consensus expectation is that interest rates are likely to rise, and elevated inflation may persist.

Should this occur, **we believe the Fund, REITs and real estate-related companies can perform well in a rising interest rate and inflationary environment.**

Real Estate In a Rising Interest Rate Environment

We believe there is a perception, for some, that REITs and real estate-related companies may perform poorly should interest rates rise.

We acknowledge that a sharp and rapid rise in interest rates would increase financing costs and may negatively impact the relative appeal of some dividend yielding securities such as REITs, yet we believe a sharp and rapid rise in interest rates could also unsettle the broader equity market. An increase in interest rates that reflects an improvement in the economy, however, often leads to an improvement in real estate business fundamentals–occupancy gains, rent increases, and cash flow growth.

We believe the Fund and many REITs can perform well in a rising rate environment if real estate business fundamentals are improving, and both the rate of change in interest rates does not create sticker shock and the ultimate level of interest rates does not become a headwind to operating performance.

Recent case study – March 9, 2020 to October 8, 2021

Since bottoming at 0.54% on March 9, 2020, the 10-year Treasury yield has increased 107 basis points to 1.61% as of October 8, 2021. During this period of rising interest rates, the Baron Real Estate Income Fund increased 56.3% on a cumulative basis, which compares favorably to the REIT Index which increased 27.9%.

A review of additional time periods (such as the Fed interest rate hike cycle that began in 2004) also supports the notion that REITs can perform well in a rising interest rate environment.

Real Estate As an Inflation Hedge

Historically, certain real estate businesses have had the ability to raise prices to provide inflation protection:

- Inflation-linked property value and pricing power

  Higher prices for labor, land, and materials may constrain new real estate construction (increase in costs are currently outstripping the increase in rents which leads to lower development returns) thereby supporting the ability for current landlords in supply-constrained markets to increase occupancies and pass along higher operating costs by raising rents (i.e., pricing power).

- Short-lease duration

  Real estate segments with short-lease terms could raise rents relatively quickly to offset inflation. Examples include: hotels (1 day); self-storage real estate (30 days); apartments (1 year); single-family rental homes (1 year); and senior housing facilities (1 year).

- Annual rent escalators

  Certain real estate leases have contractual annual rent escalators, in some cases tied to an inflation index (i.e., consumer price index).

Playbook For Rising Rate or Inflationary Environment

If it became clear that interest rates and inflation would continue to rise and remain elevated, we could implement elements of our well-tested playbook. They include the following:

- Focus on short-lease duration real estate and minimize exposure to long-lease duration real estate. REITs and real estate-related companies such as hotels, self-storage, apartments, single-family home rentals, senior housing operators, and other types of real estate companies can re-price more often to take advantage of interest rate fluctuations. They are likely to grow faster as the economy improves and can better offset increases in interest rates than REITs that focus on office buildings, shopping centers, and malls, which may be saddled with 5- to 10-year leases.
- Emphasize REITs and real estate-related companies that will benefit disproportionately from an improvement in the economy, such as residential-related REITs hotels, and gaming to the extent there is a real estate component.
- Own real estate companies with a strong pipeline of future development projects.
- Invest in companies with strong balance sheets that can weather a rise in interest rates.
- Carefully monitor our REIT versus non-REIT exposure. Some REITs may be more susceptible to higher borrowing costs than other non-REIT real estate companies because REITs must pay out at least 90% of their taxable income in dividends and therefore are more reliant on access to the debt markets.

Concluding Thoughts

We are mindful of concerns about the outlook for the markets. Some of the concerns include:

- Elevated inflation – in part due to supply chain bottlenecks
- Continued uncertainty regarding the Fed's future action on tapering its bond purchases and raising interest rates
- Negative real yields
- Uncertainty regarding China's regulatory environment, slowing economy, and the possible spillover effects
- Never-ending gridlock and worsening partisan politics in the U.S.
- Rising energy prices
- Geopolitical and humanitarian crises
- Elevated valuations for certain segments of the stock market

While we recognize that in the months ahead there may be choppy periods in the market, we remain directionally positive about the prospects for real estate and the Fund.

Following generally strong performance of the stock market, real estate, and the Fund, we have recently been asked the following question:

Have We Missed the Recovery In Real Estate?

Our answer: No

- We believe we are in the early innings of a new real estate cycle.
- Real estate demand should continue to improve if the headwinds from COVID-19 and the Delta variant continue to subside.
- Slower supply growth should support occupancy, rent growth, and cash flow growth.
- Interest rates – though they may rise a bit – appear likely to remain low relative to history given tremendous central bank support, ongoing global economic challenges, and the strong desire for yield and relative appeal of U.S. Treasuries.
- Valuations remain attractive for several REITs and real estate-related companies.
- Certain types of REITs and real estate-related companies may deliver strong relative returns in an inflationary environment.

We Remain Optimistic About the Prospects for Baron Real Estate Income Fund.

- The Fund is composed of quality companies.

  We have 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 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 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 and other dividend-yielding real estate companies.

Table X.
Top 10 holdings as of September 30, 2021

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Invitation Homes, Inc.	$ 22.8	$4.9	5.7%
Equity Residential	30.3	4.4	5.2
American Tower Corp.	120.8	4.4	5.2
AvalonBay Communities, Inc.	30.9	4.3	5.1
Simon Property Group, Inc.	42.7	3.3	3.9
Travel + Leisure Co.	4.7	3.1	3.6
Brookfield Infrastructure Partners L.P.	23.4	3.1	3.6
Prologis, Inc.	92.8	3.0	3.6
Public Storage Incorporated	52.1	2.8	3.3
Ventas, Inc.	21.7	2.8	3.2

Thank you 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 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.

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

BAMCO, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission (SEC). Baron Capital, Inc. is a limited purpose broker-dealer registered with the SEC and member of the Financial Industry Regulatory Authority, Inc. (FINRA).