BARON CAPITAL

Jeff Kolitch: Real Estate Equities Are Still Attractive

This is an edited version of a February 2, 2022, Q&A with Jeff Kolitch, Portfolio Manager of Baron Real Estate Fund and Baron Real Estate Income Fund. To access the recording, please dial800-633-8284, passcode #22015240.

Executive Summary

- We believe REIT growth prospects are compelling, fueled by improved demand and constrained supply, growth through acquisitions, and development/redevelopment which could accelerate cash flow growth.
- Public real estate is essentially "on sale" relative to private real estate. We believe the favorable arbitrage between public and private market valuations bodes well for public market investors. Either share prices in the public market will rise to more appropriate valuations, or private equity will acquire these companies at big premiums to where they currently trade.
- During the 12-plus years that we've managed our real estate strategy, there were six periods in which the US 10-year Treasury yield increased by at least 80 basis points. Our strategy outperformed the REIT index every time. In five of those periods, we generated positive absolute performance.
- Our team is vigilant about monitoring factors that would cause us to turn more cautious. The current view on each of those factors is encouraging. We don't see the typical excesses that would foreshadow the end of an economic or real estate cycle.
- As investors, the current move toward normalization – whether it be interest rates, inflation, valuation multiples, maybe stock market returns, or the pandemic – requires precision. It requires more active management, more critical judgment. While the return path may be bumpy, our team welcomes the challenge.

Introduction and Fund performance

Jeff Kolitch manages Baron Real Estate Fund and Baron Real Estate Income Fund. Jeff has 30 years of investment experience. Before joining Baron in 2005, Jeff spent 10 years at Goldman Sachs, starting as a research analyst and moving to managing director in 2002. He launched Baron Real Estate Fund, which invests in REITs and other real estate-related companies, in 2009; and Baron Real Estate Income Fund, which emphasizes REITs and other dividend-yielding real estate companies, in 2017.

Since inception through 12/31/2021, Baron Real Estate Fund has a cumulative return of 580%, far out distancing the 364% return of the MSCI Extended Real Estate Index and more than double the 254%

cumulative return of the MSCI US REIT Index.

As of 12/31/21, the Fund has a 5-star overall rating from Morningstar, as well as a 5-star rating for each of its 10-year, 5-year and 5-year performance periods.

The Fund ranked as the #1 real estate fund for each of the 10-year, 5-year and 3-year performance periods.

Since inception, Baron Real Estate Income Fund has a cumulative return of 92.5%, almost double the 51.5% cumulative return of the US REIT Index. As of 12/31/21, the Fund has a 5-star rating overall and for the 3-year period from Morningstar and ranked in the top 3rd percentile of all real estate funds for the 3-year period.

As of 12/31/2021, the Morningstar Ratings™ were based on 233, 200, 149, and 233 share classes for the 3-year, 5-year, 10-year, and Overall periods, respectively. The Baron Real Estate Fund received 5, 5, 5, and 5 stars, respectively. The Baron Real Estate Income Fund received 5 Stars for both the 3-year and Overall 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 12/31/2021, the Morningstar Real Estate Category consisted of 253, 233, 200, and 149 share classes for the 1-, 3-, 5-, and 10-year periods. Morningstar ranked Baron Real Estate Fund Institutional Share Class in the 89th, 1st, 1st, and 1st percentiles, respectively. On an absolute basis, Morningstar ranked Baron Real Estate Fund Institutional Share Class as the 229th, 2nd, 2nd, and 1st best performing share class in its Category, for the 1-, 3-, 5-, and 10-year periods, respectively.

Morningstar ranked Baron Real Estate Fund R6 Share Class in the 88th, 1st, and 1st percentiles, for the 1-, 3-, and 5 year periods, respectively. On an absolute basis, Morningstar ranked Baron Real Estate Fund R6 Share Class as the 228th, 1st, and 1st best performing share class in its Category for the 1-, 3-, and 5-year periods, respectively.

Morningstar ranked Baron Real Estate Income Fund in the 85th 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.

Q&A with Jeff Kolitch

Let's start with your high-level view for real estate in 2022

Clearly this is a normalization or transition year. While we're mindful of the risks to the equity and real estate market, we're bullish about the prospects for several segments of public real estate, both REIT and non-REIT.

Over the last few years, our focus has been on companies that are positioned to benefit from the three building blocks of total return: 1) earnings or cash flow growth, 2) company valuations, and 3) dividend yield. And over the last three years, average annual returns for the Funds have been very strong — over

38% for Baron Real Estate Fund, and just under 30% for Baron Real Estate Income Fund.

Now I want to be clear: It is highly unlikely that we will continue to generate 30%-plus returns. It's just not sustainable. However, we do think both strategies can continue to generate solid, absolute and relative returns — perhaps 20%-plus returns from current levels for the balance of the year.

We see several fundamental elements that should support real estate:

1. The relationship between demand and supply is still generally favorable.
2. Business conditions remain solid for most of our companies. Balance sheets are strong. The cycle has reset.
3. There is a staggering amount of private capital pursuing real estate ownership, supported by widely available debt capital, still at very low interest rates.
4. We think it is a question of when, not if, real estate merger and acquisition activity accelerates.
5. Most important, we see quite a few companies that are attractively valued.

What about REITs in particular?

At the end of 2020, we believed REITs would perform well in 2021. We saw that REITs and real estate in general would be prime beneficiaries of a reopening economy. The REIT Index did, in fact, deliver its best year ever, up just over 40%. We think REITs should perform well this year as well, albeit with somewhat lower returns than in 2021. Business fundamentals have stabilized, and they're strong. Headwinds began to recede last year, and we expect that to continue. So, certain segments of real estate will likely benefit from an ongoing economic recovery.

REIT growth prospects are notably compelling, fueled by improved demand and constrained supply, growth through acquisitions, and development and redevelopment, which could accelerate cash flow growth. Among the REITs we're evaluating, we see potential for 9% to 10% bottom-line earnings growth this year and next year. That's more than double the 15-year average of about 4%.

How do interest rates and the inflationary environment factor into your outlook?

We have no doubt that both of our strategies can continue to perform well in a rising rate environment. During the 12-plus years that we've been managing our real estate strategy, there have been six periods when the US 10-year Treasury yield increased by at least 80 basis points. Our strategy outperformed the REIT index every time. In five of those periods, we generated positive absolute performance. In 2013, the 10-year Treasury went from 1.7% in May to 3% at the end of the year -- about 130 basis points in about seven months. The Baron Real Estate strategy increased almost 28% that year, far out distancing our benchmarks. Our REIT income strategy can also perform well in a rising rate environment. Since rates bottomed in March of 2020, the 10-year Treasury increased by about 100 basis points, ending 2021 around 1.5%, up from a 0.5% in March. During that period, our income strategy increased about 75%, which compares quite favorably to the REIT index, which went up about 46%.

What can you tell us from a micro-level perspective?

Our research leads us to the conclusion that several real estate companies offer compelling prospects for growth, dividend and, given the recent correction in the share prices of some of our holdings and companies we track, opportunities for improved valuation. There is a lot we like, but here's a sampling.

We've owned **Brookfield Asset Management, Inc.** since the Baron Real Estate strategy launched. It was our largest position then, and it's still our largest position. This is one of the largest owners and operators of real estate and infrastructure assets in the world, led by a world-class CEO. The management team has laid out a path to grow the business and the share price from the mid-$50s, where it is today, to about $150 over the next four-plus years. Also, this team has a track record of under-promising and over-delivering.

Jones Lang LaSalle Incorporated is a terrific proxy for commercial real estate investing, as well as **CBRE Group, Inc**. These are the two leading commercial real estate service firms in the world. They're number one or number two in every business line. In the case of Jones Lang, it's growing faster than the S&P 500. Most non-REIT companies in the S&P 500 have stronger balance sheets and are growing faster than most REITs in the index, yet Jones Lang is trading at 12 times earnings, and it maintains a pristine balance sheet.

Boyd Gaming Corporation, one of the largest and most successful regional gaming companies in the U.S., owns and operates 28 casino companies in 10 states. Business conditions are strong; management maintains a liquid and conservative balance sheet. Insiders own almost 30% of the company, and the shares are cheap. It's valued at seven and a half times cash flow, a double-digit free cash flow yield, and we believe it's an attractive acquisition candidate should its current valuation remain discounted relative to recent private market casino and gaming transactions.

We're bullish on leisure travel. These shares are just too cheap. We're bullish on the prospects for **MGM Resorts International,** a leading global casino company. This management team has done a tremendous job executing on a multi-year transformation of its business. It's an asset-like business. It has the leading internet-based casino business in the U.S. with a 30% market share. It's sitting on close to $10 billion in cash right now, which will be deployed for growth opportunities and stock buybacks and dividends. We think the shares can go up 50% over the next couple of years.

Among REITs, we are particularly bullish on residential opportunities, where we see robust demand, strong growth, reasonable valuations, and assets that provide a measure of inflation protection given their short lease duration. **Invitation Homes, Inc**. is the largest owner of single-family rental homes in the U.S., with about 80,000 homes. We think the company is going to double that number over the next five to 10 years and grow its cash flow 10% per year. So, we have that trifecta opportunity: growth plus dividend plus improved valuations. That trifecta translates to mid-teens returns.

Equity Residential, the largest apartment landlord in the country, is one of the top positions in both of our strategies. Management believes the company will post the best numbers in its history in 2022, in terms of same-unit revenue growth.

We see attractively valued companies across many subcategories. Certain hotels are trading at 30% to 50% discounts to replacement costs. There are office landlords priced at 50% to 60% discounts to replacement costs, despite occupancy and rental pressures. There are even some retail real estate companies, residential-related companies, homebuilders, and residential-related building product companies that have just been “thrown out” and now are, in our opinion, quite attractively valued.

How do you view private real estate vs. public?

At this point, public real estate is essentially on sale relative to private real estate. We believe the return prospects in the public market are superior. Said differently, there's a favorable arbitrage between public and private market valuations. We believe that bodes well for public market investors because one of two things is going to happen: either share prices rise organically in the public market to more appropriate valuations, or private equity acquires these companies at big premiums to where they currently trade. I could give a lot of examples, but here are a few:

- Apartments are trading in the private market in a mid-to-high 3% cap rate range. They're trading in the public market in the low 4% cap rate range. Blackstone made a $6 billion acquisition of a single-family home rental company at about a 3.5% cap rate in 2021. The companies we own are at a mid 4% cap rate, and frankly, we think they're superior companies.

- In the life science niche, a very compelling area, Blackstone and Ventas both recently purchased several office buildings at anywhere from $1,300 to $1,500 per square foot. We own what we think is the premier life science real estate portfolio in the country, **Alexandria Real Estate Equities, Inc.**, which is valued at only $900 per square foot.
- Data center REITs have recently been bought for mid- to high-20s cash flow multiples. We own stock in what we believe is the premier data center company in the world, **Equinox, Inc.**, which trades at just 23 times cash flow.

Are you still bullish on the housing market?

This has been a multi-year theme for us. Two factors underpin our optimism over the long term. One is the structural underinvestment in residential construction relative to the demographic need. Second, powerful cyclical and secular tailwinds should aid the housing market in the years ahead.

We're a bit more cautious about the near-term prospects for the “for-sale” portion of the market. We're mindful of a possible temporary slowdown should interest rates and mortgage rates spike. This is something we're monitoring very closely, as well as the potential for near-term headwinds in the form of material and labor bottlenecks. We own **D.R. Horton, Inc.,** one of the most respected home builders in the country, in our Baron Real Estate strategy. Their management team believes that, absent a significant spike, their prospects remain strong, and they remain bullish.

How do you view the prospects for office real estate?

We're long-term cautious. Yet, we do think there are some near-term tactical opportunities because share prices have overshot to the downside. The work-from-home dynamic and the outlook for office real estate has been perhaps the most talked-about real estate topic since the pandemic emerged. There's no question this headwind is going to pressure occupancy and rents for the next few years. There was also a fair amount of construction in certain markets pre-pandemic that will be delivered over the next few years. Despite those challenges, we believe the correction in share prices far exceeds the likely decrease in office cash flows. That's what we mean when we say there are tactical buying opportunities in certain office REITs. For example, we own a few office REITs in our income strategy that are currently valued at 40% to 50% discounts to their liquidation value or net asset value.

What concerns you, despite the optimism?

We are always concerned about what could go wrong in our thesis. Our team is vigilant about monitoring factors that would cause us to turn more cautious. Key items that we study closely include construction activity, demand prospects, lending practices, bank liquidity, interest rates, and valuations The current view on each of these is encouraging. We don’t see the typical excesses that would foreshadow the end of an economic or real estate cycle.

As for concerns, the first has nothing to do with real estate analysis. That would be a new COVID variant emerging, and once again slowing down the reopening of the global economy. We have no visibility into that. We're aware of it. We move on.

The second concern is that the Fed’s tightening cycle leads to a significant slowdown in economic activity. Given that consumer spending is 70% of GDP, our team is spending a lot of time questioning our management teams about consumer trends, and we’ll continue to do so.

The last concern would be around interest rates. A sharp, rapid rise in rates would increase financing costs, and could negatively impact the relative appeal of certain securities, REITs, or other real estate categories. As I said earlier, our strategies can perform well in a rising rate environment if business fundamentals are improving, the rate of change in rates doesn’t create sticker shock, and the ultimate level doesn't become a headwind to performance.

Any closing thoughts?

As investors, the move toward normalization – whether interest rates, inflation, valuation multiples, pandemic-related issues – requires precision. It requires more active management, more critical judgment. While the return path may be bumpy, our team welcomes the challenge. We are positive on where we'll be at year-end.

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

Baron Real Estate Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 24.36%; 5-years, 21.57%; 10-years, 18.18%; Since Inception (12/31/2009), 17.32%. Annual expense ratio for the Institutional Shares as of December 31, 2021 was 1.08%. The **MSCI USA IMI Extended Real Estate Index**'s annualized returns as of December 31, 2021: 1-year, 36.55%; 5-years, 14.32%; 10-years, 14.29%; Since Fund Inception (12/31/2009), 13.26%.

Baron Real Estate Income Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 29.58%; 3-years, 29.34%; Since Inception (12/29/2017), 17.79%. Annual expense ratio for the Institutional Shares as of December 31, 2021, was 3.45%, but the net annual expense ratio was 0.80% (net of the Adviser's fee waivers). The **MSCI US REIT Index**'s annualized returns as of December 31, 2021: 1-year, 41.71%; 3-years, 17.17%; Since Fund Inception (12/29/2017), 10.94%.

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.

Risks: In addition to general market conditions, the value of the Funds will be affected by the strength ofthe real estate markets as well as by interest rate fluctuations, credit risk, environmental issues and economic conditions. The Baron Real Estate Income Fund invests in debt securities which are affected bychanges in prevailing interest rates and the perceived credit quality of the issuer. The Funds invest 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.

The discussion of market trends is not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this document reflect those of the respective writer. Some of our comments are based on management expectations and are considered "forward- looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

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 3stars, 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 withits three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-yearrating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 monthsof 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.

Portfolio holdings for both funds as a percentage of net assets as of December 31, 2021, for securities mentioned are as follows: - **Brookfield Asset Management, Inc.** - Baron Real Estate Fund (4.6%); **Jones Lang LaSalle Incorporated -** Baron Real Estate Income Fund (4.2%); **CBRE Group, Inc.** – Baron Real Estate Fund (3.0%); **Boyd Gaming Corporation** – Baron Real Estate Fund (4.2%), Baron Real Estate Income Fund (3.4%); **MGM Resorts International** – Baron Real Estate Fund (3.4%), Baron Real Estate Income Fund (0.8%); **Invitation Homes** –Baron Real Estate Income Fund (5.7%); **Equity Residential** – Baron Real Estate Fund (2.5%), Baron Real Estate Income Fund (5.2%); **Alexandria Real Estate Equities, Inc.** – Baron Real Estate Fund (1.4%), Baron Real Estate Income Fund (1.5%); **Equinox, Inc.** – Baron Real Estate Fund (1.7%), Baron Real Estate Income Fund (3.2%); **D.R Horton, Inc.** – Baron Real Estate Fund (2.3%).

Top 10 holdings as of December 31, 2021

Baron Real Estate Fund

Holding	% Assets
Brookfield Asset Management Inc.	4.6
Jones Lang LaSalle Incorporated	4.2
Boyd Gaming Corporation	4.2
Marriott Vacations Worldwide Corp.	4.1
MGM Resorts International	3.9
Lowe's Companies, Inc.	3.7
Red Rock Resorts, Inc.	3.4
CBRE Group, Inc.	3.0
American Tower Corp	2.9
Lennar Corp.	2.8
Total	36.8

Baron Real Estate Income Fund

Holding	% Assets
Invitation Homes, Inc.	5.7
American Tower Corp.	5.6
Rexford Industrial Realty, Inc.	5.2
Equity Residential	5.2
AvalonBay Communities, Inc.	5.1
Prologis, Inc.	5.0
Simon Property Group, Inc.	4.8
Public Storage Incorporate	3.8
Brookfield Infrastructure Partners L.P.	3.5
Boyd Gaming Corporation	3.4
Total	47.3

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

The **MSCI USA IMI Extended Real Estate Index** is a custom index calculated by MSCI for, and as requested by, BAMCO, Inc. The index includes real estate and real estate-related GICS classification securities. The **MSCI US REIT Index** is an unmanaged 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 makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. The indexes and the Funds include reinvestment of interest, capital gains and dividends, which positively impact the performance results. The indexes are unmanaged. Index performance is not fund performance. Investors cannot invest directly in an index.

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